

Annual Report 2004

COSTCO
WHOLESALE

YEAR ENDED AUGUST 29, 2004

2004

PLAINTIFF'S EXHIBIT	
CASE NO.	CV04-0360P
EXHIBIT NO.	214

COSTCO_003580

COSTCO_003580

THE COMPANY

Costco Wholesale Corporation ("Costco" or the "Company") began operations in 1983 in Seattle, Washington. In October 1993, Costco merged with The Price Company, which had pioneered the membership warehouse concept in 1976, to form Price/Costco, Inc., a Delaware corporation. In January 1997, after the spin-off of most of its non-warehouse assets to Price Enterprises, Inc., the Company changed its name to Costco Companies, Inc. On August 30, 1999, the Company reincorporated from Delaware to Washington and changed its name to Costco Wholesale Corporation, which trades on the NASDAQ under the symbol "COST."

Costco operates a chain of membership warehouses that sell high quality, nationally branded and selected private label merchandise at low prices to businesses (Business Members) purchasing for commercial use, personal use, or resale, and also to individuals (Gold Star Members). The Company's business is based upon achieving high sales volumes and rapid inventory turnover by offering a limited assortment of merchandise in a wide variety of product categories at very competitive prices. As of December 2004, the Company operated a chain of 449 warehouses in 37 states and Puerto Rico (333 locations), nine Canadian provinces (63 locations), the United Kingdom (15 locations), Korea (five locations), Taiwan (three locations, through a 55%-owned subsidiary) and Japan (five locations), as well as 25 warehouses in Mexico through a 50%-owned joint venture.

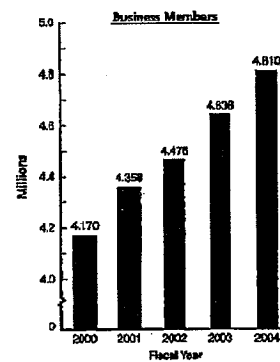
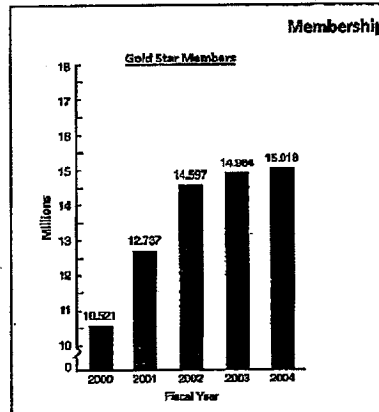
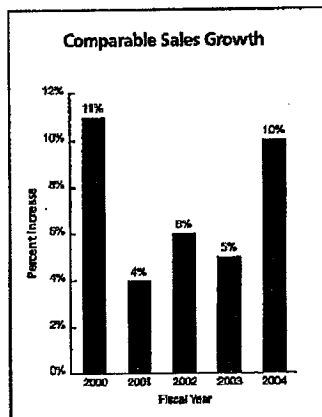
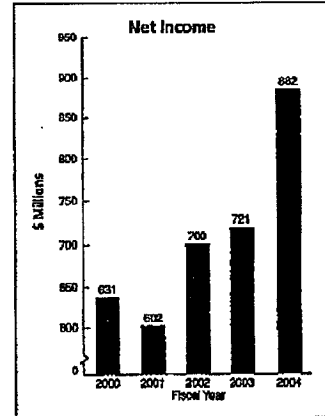
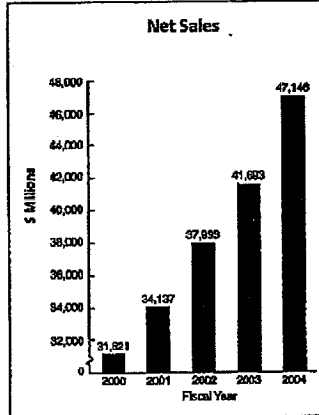
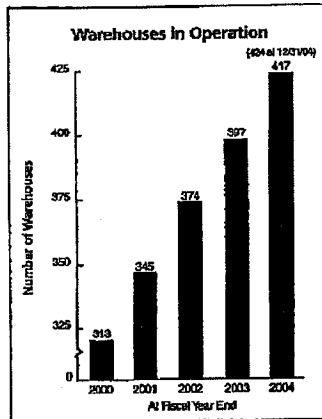
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FINANCIAL HIGHLIGHTS

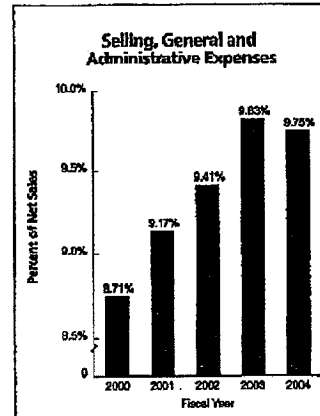


Average Sales Per Warehouse *
(Sales in Millions)

Year Opened	# of Whses*	1995	1996	1997	1998	1999	2000	2001	2002	2003	2004
2004	20									\$72	
2003	24								\$67		78
2002	29							\$58	62	77	
2001	32						\$57	63	72	84	
2000	21					\$57	65	77	85	98	
1999	15				\$65	77	86	97	105	120	
1998	17				\$50	68	72	77	82	86	91
1997	10			\$56	70	85	99	108	113	115	124
1996	18		\$46	53	61	68	80	83	87	94	104
1995 & Before	281	\$75	79	86	92	100	110	114	119	124	134
Totals	417	\$76	\$77	\$83	\$87	\$94	\$101	\$101	\$103	\$105	\$115

Fiscal Year

*First year sales annualized.



December 10, 2004

Dear Costco Shareholders:

Fiscal 2004 was an exciting year for Costco, where we were able to show solid growth, not only in our merchandising and sales efforts, but also substantial progress in operational controls, which when combined, resulted in an improved bottom line. After three years of rapid expansion into many new markets; a rising cost structure, associated not only with this expansion, but also with highly inflationary healthcare and workers' compensation expenses; and earnings growth of just under 5% per year during that period, we are pleased to report that fiscal 2004 was a banner year for Costco, highlighted by record sales and earnings! Most of the Company's fiscal 2004 financial goals were met or exceeded; and in addition to record sales and profits, we grew and strengthened our membership base; leveraged our strong sales results to reduce our operating expense percentages; expanded our operations worldwide with 23 new warehouse openings; and declared our first quarterly cash dividend. We achieved these results by focusing on what we do best—fulfilling our corporate mission and sticking to our game plan.

Our 2004 fiscal year ended August 29th, with net sales of \$47.1 billion, an increase of 13% over 2003's \$41.7 billion. On a comparable warehouse basis, comparing sales of buildings that had been open at least a year, our sales were up 10% in 2004, double our 2003 increase of 5%. We also increased our gross margin in 2004, bringing it up to 10.72%, from 10.69% in 2003. Equally important, after four years of increasing operating expense percentages, we reduced our expense ratio from 9.83% in 2003 to 9.75% in 2004, an improvement of eight basis points as a percentage of sales. These are trends that we hope will continue.

Costco is now the fifth largest retailer in the United States and the 11th largest in the world, standing at number 29 in the Fortune 500. We finished fiscal 2004 with 441 warehouses operating in 36 U.S. states, Puerto Rico and seven countries. Typically, our per unit sales are nearly double those of our nearest competitor. In fiscal 2004, our average annual sales per warehouse were \$115 million, up from \$105 million in 2003. For U.S. buildings, the 2004 average was \$121 million. We are committed to continue driving higher levels of sales by doing what we do best—being the most innovative merchant and providing our members the best merchandise and services at the lowest overall prices.

Our ongoing goal of increasing shareholder value is accomplished by conscientiously living our mission statement and code of ethics each and every day... *To bring the highest quality goods and services to market at the lowest possible prices... and to obey the law, take care of our members, take care of our employees, respect our suppliers and reward our shareholders.*

As Costco's founders, we take personal pride in the highly ethical way Costco conducts business—day in and day out. Throughout our 21 years in business, we have come to be viewed as the Company that has achieved unquestioned "*pricing and value authority*"—a position we have earned and that we value. We assure you that we will continue to work hard to maintain that reputation. Our priorities demand that we continue to delight our members every day. We want each shopping experience to be the best in terms of quality, value and service—and we want it to be fun. We strive to keep an undercurrent of excitement in our buildings, where our members can shop with the anticipation of finding unexpected treasures, while purchasing their everyday needs with the assurance they have received the best value—price and quality—available. This past year, we increased our staffing at the front-end registers, expediting the checkout process and enhancing our members' overall shopping experience, leading, we believe, to more frequent shops and higher sales with minimal increases in expense.

We continued our expansion in fiscal 2004, opening 23 new warehouses, including three new warehouses in our Mexico joint venture. Most of these new locations were added to existing markets, improving our accessibility and service to our members. Experience has taught us that our strong markets can successfully support many additional Costco warehouses. In fact, our results consistently show that existing locations profit from "in-filling," bringing us a significantly higher return on investment in a shorter period of time than is common in new markets. Accordingly, we will increasingly tailor our growth plans to reflect a majority of new Costco buildings in existing markets, most likely resulting in more than two-thirds of our openings being located in existing "in-fill" markets, rather than new markets.

Opening day sales for most of our new locations were extraordinarily high this year, some breaking previous records set by some of our most successful buildings. In the United States, our new-market buildings were in Hoover, Alabama; El Paso, Texas; Myrtle Beach, South Carolina and Greensboro, North Carolina. Our infill buildings were opened in Commerce Township, Michigan; Chantilly and Leesburg, Virginia; Citrus Heights, Turlock and Poway, California; South Ogden, Utah; Coeur d'Alene, Idaho; Vancouver, Washington; Lewisville, Texas; Enfield, Connecticut and Lake in the Hills, Illinois. We also opened our fifth Business Center in Pife, Washington.

The demand for American goods remains high around the world, fueling our international expansion. Two of our three new warehouses in Mexico were in new markets (Cuernavaca and Cabo San Lucas), while adding one in our existing high-volume market of Tijuana. Also, as we discussed at our last two shareholders' meetings, we opened Muros Cultural Center in Cuernavaca, Mexico, a stunning facility that houses the world-famous Jacques and Natasha Gelman Collection of Modern and Contemporary Mexican Art, along with the restored murals of Casino de la Selva. In Canada, we added two new in-fill buildings (Terrebonne, Quebec and London, Ontario). We feel we have only begun to tap the potential of the international marketplace for Costco, and we look forward to continued global expansion and success. So far in our Fiscal 2005 first quarter, we added our fifth Costco in Japan; and we are preparing for a spring opening in Bristol, England, which will bring our total to sixteen Costcos in the United Kingdom.

In fiscal 2005, we plan to open 22 to 25 additional new warehouses and relocate seven existing locations. Eleven of these (including three relocations) will be operating before calendar year-end, bringing our total warehouses at the end of calendar 2004 to 449. Buildings opened in the Fall of 2004 were widespread geographically: one in Illinois; one in Arizona; one in Minnesota; one in Iowa; two in Michigan; one in Mexico; and, as mentioned above, one in Japan. We believe the market is far from saturated. In fact, we feel confident that given recent successes and market conditions, we should be able to double our present number of warehouses over the next ten years, given the combination of U.S. and international opportunities.

We continue to look at other types of businesses that fit well within the Costco model. In fact, in October 2004 we opened our second Costco Home location adjacent to a high-volume Costco warehouse in Tempe, Arizona. Our first Costco Home, featuring high-end furniture and accessories, has been profitable since opening in December 2002, despite its "stand-alone" location in Kirkland, Washington. We feel the highly visible location of our new facility will draw additional traffic, thanks to its proximity to the Tempe warehouse, perhaps giving us a model to build on for future expansion of this business in markets where we have multiple Costco warehouses and hundreds of thousands of loyal Costco members. Our strategy, as we have mentioned before, is two-fold—first, make it more attractive to be a Costco member; and second, learn something in these businesses that will make all of our 449 Costcos better.

The high quality and value we offer in our ancillary businesses continue to set us apart from our competition and bring our members in for additional shops, increasing incremental sales. Our 211 gas stations brought in sales of \$2.3 billion in 2004, an increase of 45% over 2003. We have a well-earned reputation of being the best-priced pharmacy in every U.S. market in which we operate. Last year, we filled 18 million prescriptions and had sales of \$2.2 billion, an increase of 11% over 2003. Our food courts sold more than fifty million hot dog and soda combinations in 2004, with our giant Kosher dogs regularly being named "Best Hot Dog" in local competitions across the country. And our Optical, 1-Hour Photo and Hearing Aid centers are thriving operations and all showed double-digit gains last year.

Our E-commerce business, at costco.com, continues to grow exponentially, and last year had sales of over \$375 million, an increase of 66% over the prior year. As much as costco.com has grown, we believe we have barely touched the surface of this format, and forecast continued significant growth and leadership in the E-commerce industry. Over the next several years we believe that costco.com, our "virtual warehouse," can become a \$5 billion business, helping us to leverage our existing relationships with suppliers, as well as expand our membership base.

The initial rollout this past year of E-commerce order stations in our buildings brings costco.com to our warehouse shoppers and enhances our top-notch, special-order kiosk offerings. While saving money on the basics, our members can choose from a wide variety of value-priced luxury items, whether found while treasure-hunting the aisles or in special-order kiosks or at our upscale road shows within our warehouses.

As you may know, Costco is one of the largest dealers of fine diamonds in the country, with over 67,000 carats sold this past fiscal year. Likewise, the value we provide in fine wines is unparalleled. In fact, we have recently expanded our fine wine offering by developing our own Kirkland Signature wine—a full-bodied Shiraz from Australia's Barossa Valley—complementing our earlier successes with Kirkland Signature Chardonnay and Cabernet Sauvignon. As with all of our private label Kirkland Signature products, it represents the highest quality and best value available.

Our reputation is solidly built on our underlying philosophy of carrying the highest quality national brands at the lowest possible prices; and even as we expand our Kirkland Signature private label, we continue to develop relationships with new merchandise suppliers. Our suppliers are our partners in business, and we believe in establishing alliances with them that enable both of us to prosper. We recently built new direct relationships with Kitchen Aid, Osh Kosh, Sony Computers, Sony TVs, Godiva, Pioneer, Lane Furniture, Royal Sateen, Samsung, Levi's, and FILA. We also have co-brands with Starbucks, Hanes, Foster Farms, Mariani's, Jelly Bellies, Tyson, DeLacre, Newman's and Hanson's.

All of these merchandise strategies are designed to help us give our members the highest quality and best values in the marketplace. Exceeding our members' expectations is our constant goal. We currently have 23.4 million loyal member households, representing 42.4 million Costco cardholders. Member renewals are strong, running 86% for our membership overall, and 93% for Executive Members. We now have 3.1 million Executive Members in the U.S. and Canada, who pay \$100 a year to take advantage of some 23 Executive Member services Costco now offers, while receiving a 2% Executive Member reward on their qualified purchases. We have found that these are our best customers—members who spend higher average amounts and increase their spending each year.

Of course, as proud as we are of Costco's achievements in fiscal 2004, we realize that the Company's bottom line is also very important to you, our shareholders. We have worked hard throughout our Company's history to control expenses; and we are extremely pleased to say that, thanks to the success of several initiatives begun last year, we believe we have made some lasting improvements that will serve the dual purpose of better expense ratios and improved service to our Costco members.

As you know, we made changes to our health care plans that went into effect in October 2003—changes designed to bring a balance between rising health care costs and the need to educate our employees on how to be better health care consumers. Our new plans are expected to increase the percentage employees contribute from 4% to 8% over a four-year period. We have already seen a cost improvement in this area. Nevertheless, our employee benefits are still the best in our industry, and we will ensure that they remain so.

Our current expansion plans, while still aggressive, should not interfere with our cost-cutting initiatives. We saw expense improvements in 2004, and we expect more in 2005. Additionally, while we believe Costco has the lowest inventory shrinkage rate in retail, we felt we could do better; and this year we reduced it even further, achieving the best results in the Company's history. By challenging everything we do, we also lowered our operating expense ratios in our home and regional offices in 2004, and we continue to hold the line on utility costs. Costco was built on cost-saving efficiencies, and we are committed to continually reducing costs wherever we can through innovative problem-solving.

A big part of our success stems from our creative and cohesive management team, many of whom have been working together for more than 20 years at Costco, and for up to 40 years in retail. They are, we believe, the strongest team in the industry and are highly sought after. We are also aggressively developing new leaders within Costco's employee base, and we have a new generation primed and ready to assume management roles as we expand our business.

This year saw a realignment of some of our executive officers. Franz Lazarus, Executive Vice President of International Operations and a senior executive with the Company since its inception, recently retired. We appreciate the many contributions Franz has made over the years to the success of the Company, and we will certainly miss him. Replacing Franz are Jim Murphy, formerly Senior Vice President of our United Kingdom operations, who has assumed leadership of our International Division, and Richard Chavez, formerly Senior Vice President of our Asia operations, who is now head of our Manufacturing and Other Businesses Division.

Dick DiCerchio, Senior Executive Vice President, COO, Merchandising, has assumed leadership over all Costco warehouse operations in the United States and around the world. Craig Jelinek, previously Executive Vice President, COO, Northern Division and Midwest Region Operations, is now responsible for all Costco Merchandising. Doug Schutt, who had been Senior Vice President of E-commerce and Special Order Merchandise, was promoted to Executive Vice President, COO, Northern Division and Midwest Region; and Tom Walker, Senior Vice President of Construction and Distribution, was also promoted to Executive Vice President. Ginnie Roeglin, Senior Vice President, was promoted to head up our important E-commerce business. All of these changes work to strengthen our management team.

In October of this year, we were pleased to add Susan Decker to our Board of Directors. Ms. Decker is the Chief Financial Officer and Executive Vice President of Finance and Administration for Yahoo! Inc. Her breadth of experience—including 12 years in equity research and 4 years at Yahoo! Inc.—will be an asset to our Company, and we are fortunate and delighted to have her with Costco.

Costco remains the dominant membership warehouse club operator in the world, setting the standard for excellence and leading the industry in sales increases. Our momentum is strong in terms of both sales and earnings, and we stand on a firm financial base. We are committed to growth, both domestically and abroad; and we have the strong, cohesive organization and talented management staff necessary to successfully do so.

We'd like to thank our management team and our employees, all 110,000 of them, for their exceptional performance this past year. Their energy, dedication and ongoing efforts to continually exceed the expectations of our members, our suppliers and our communities ensure that as a company we are all doing our best for you, our shareholders.

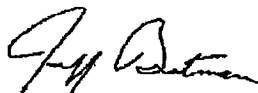
The mettle of a great company is measured by its long-term performance, the quality of its organization, the integrity of its people and the attention paid to all of its stakeholders; as well as its ability to creatively rise above adversity. Together, we can be proud that Costco exemplifies such strengths, and that they can be seen in our 2004 achievements: record sales and profits, new cost-savings initiatives and reduced SG&A, expanded operations, creative merchandising, a loyal and growing membership base, a strengthened balance sheet, and a respected business reputation.

We assure you that our management team is not complacent, and despite our successes of this past year, we know there is plenty of work left to be done. Costco has hundreds of opportunities to improve. In the future our Company can do much more to delight our customers; to be a better employer; to make the communities we serve proud; and, as a result, provide greater rewards for our shareholders. These goals remain our constant focus.

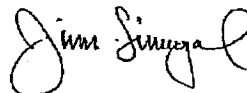
Costco is poised for more long-term growth and success—success that you will share as we continue to increase our profitability and shareholder value. We look forward to discussing our plans for Costco's future with you at our Annual Meeting of Shareholders on January 27, 2005, in Bellevue, Washington.

Thank you for your continued confidence and support. We wish you and yours a most joyous Holiday Season and a New Year abundant in success, good health and happiness.

Cordially,



Jeff Brotman
Chairman of the Board

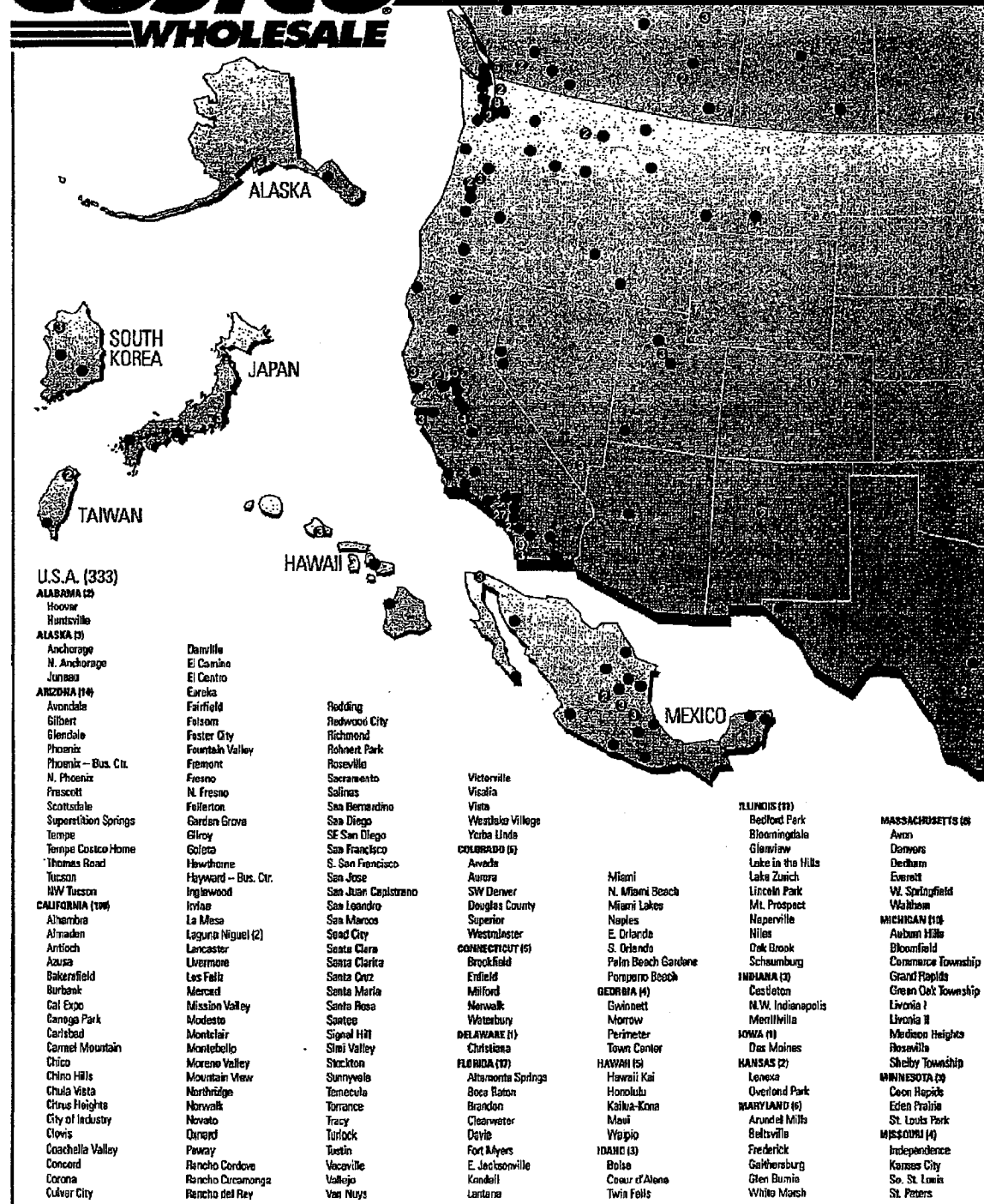


Jim Sinegal
President & CEO

COSTCO

WHOLESALE

449 LOCATIONS AS



OF DECEMBER 31, 2004



NEWFOUNDLAND



UNITED KINGDOM

UNITED KINGDOM

(15)

NOVA SCOTIA (11)

Halifax

ONTARIO (22)

Ajax

Ancaster

Bamie

Brampton

Burlington

Downsview

Etobicoke

Gloucester

Kingston

Kitchener

London

North London

Markham

Mississauga North

Mississauga South

Napier

Newmarket

St. Catharines

Scarborough

Sudbury

Vaughan

Windsor

QUEBEC (15)

Anjou

Brossard

Chicoutimi

Estimote

Laval

Marché Central

Montréal

Pointe Claire

Québec

Sainte-Foy

Saint-Hubert

Saint-Jérôme

Sherbrooke

Terrebonne

Trois-Rivières-Ouest

SASKATCHEWAN (2)

Regina

Saskatoon

JAPAN (5)

Asagasaki

Hirayama

Kanazawa Seaside

Makuhari

Tamaeater

SOUTH KOREA (5)

Daegu

Daejeon

Sang Bong

Yang Joe

Yang Pyung

TAIWAN (3)

Kaohsiang

Naihu

Shih Chih

ENGLAND (12)

Birmingham

Chingford

Derby

Gateshead

Haydock

Leeds

Liverpool

Manchester

Oldham

Reading

Thurrock

Watford

SCOTLAND (5)

Aberdeen

Edinburgh

Glasgow

MEXICO (25)

(50% Joint Venture)

AGUASCALIENTES (1)

Agua Calientes

Baja California (2)

Mexicali

Tijuana

Baja California Sur (1)

Cabo San Lucas

GUANAJUATO (2)

Calaya

Lefn

GUERRERO (1)

Acapulco

JALISCO (1)

Guadalupe

MEXICO (5)

Arboledas

Interlomas

Satellite

MEXICO, D.F. (3)

Coapa

Insuete

Polanco

MICHIGAN (15)

Morelia

MORELOS (1)

Cuernavaca

NUERO LEON (1)

Monterrey

PUEBLA (1)

Puebla

QUERETARO (1)

Queretaro

QUINTANA ROO (1)

Cancun

SAN LUIS POTOSI (1)

San Luis Potosi

SONORA (1)

Hermosillo

VERACRUZ (1)

Xalapa

YUCATAN (1)

Merida

PUERTO RICO



WASHINGTON (20)

Aurora Village

Bellingham

Burlington

Clarkston

Everett

Federal Way

File - Bus. Ctr.

Issaquah

Kanawick

Kirkland

Kirkland - Costco Home

Lynnwood - Bus. Ctr.

Payette

Seattle

Sagein

Silverdale

Spokane

N. Spokane

Tacoma

Tukwila

Turnwater

Union Gap

Yancouer

E. Wenatchee

PUERTO RICO (3)

Bayamon

Caguas

Carolina

CANADA (63)

ALBERTA (1)

N. Calgary

S. Calgary

Edmonton

N. Edmonton

S. Edmonton

Grande Prairie

Lethbridge

Red Deer

BRITISH COLUMBIA (11)

Abbotsford

Burnaby

Kamloops

Kelowna

Langford

Nanaimo

Port Coquitlam

Prince George

Richmond

Surrey

Vancouver

MANITOBA (2)

Winnipeg

E. Winnipeg

NEW BRUNSWICK (1)

Moncton

NEWFOUNDLAND (1)

St. John's

NEW MEXICO (2)

Albuquerque

Albuquerque II

NEW YORK (13)

Brooklyn

Commack

Holbrook

Lawrence

Mohville

Naveset

Nearsonet

New Rochelle

Port Chester

Queens

Staten Island

Westbury

Yonkers

NORTH CAROLINA (5)

Charlotte

Durham

Greensboro

Matthews

Winston-Salem

OHIO (4)

Avon

Desfield Township

Mayfield Heights

Springdale

OREGON (11)

Albany

Aloha

Bend

Clackamas

Eugene

Medford

Portland

Salem

Tigard

Warrenton

Wilsonville

PENNSYLVANIA (6)

Cranbury

Harrisburg

King of Prussia

Lancaster

Montgomeryville

Robinson

SOUTH CAROLINA (2)

Charleston

Myrtle Beach

TENNESSEE (3)

Brentwood

NE Memphis

SE Memphis

TEXAS (12)

Arlington

Austin

El Paso

Fort Worth

Katy Freeway

Lewisville

East Plano

West Plano

NW San Antonio

Somerra Park

Southlake

Willowbrook

UTAH (1)

Murray

S. Ogden

Orem

St. George

Salt Lake City

Sandy

VERMONT (1)

Colchester

VIRGINIA (14)

Chantilly

Chesterfield

Fairfax

Fredericksburg

Harrisonburg

W. Henrico

Leesburg

Manassas

Newington

Newport News

Norfolk

Pentagon City

Stafford

Winchester

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NUMBER OF WAREHOUSES AT FISCAL YEAR END

	Own Land and Building	Lease Land and/or Building	Total
UNITED STATES	256	71	327
CANADA	55	8	63
UNITED KINGDOM	13	2	15
KOREA	2	3	5
TAIWAN	—	3	3
JAPAN	—	4	4
Total	<u>326</u>	<u>91</u>	<u>417</u>

The following schedule shows warehouse openings (net of warehouse closings) by region for the past five fiscal years and openings (net of closings) through December 31, 2004:

Openings by Fiscal Year	United States	Canada	Other International	Total	Total Warehouses in Operation
2000 and prior	237	59	17	313	313
2001	27	1	4	32	345
2002	26	—	3	29	374
2003	19	1	3	23	397
2004	18	2	—	20	417
2005 (through 12/31/04)	6	—	1	7	424
Total	<u>333</u>	<u>63</u>	<u>28</u>	<u>424</u>	

At August 29, 2004, the Company operated (through a 50%-owned joint venture, of which Costco is the managing partner) 24 warehouses in Mexico. These warehouses are not included in the number of warehouses open in any period because the joint venture is accounted for using the equity method and, therefore, its operations are not consolidated in the Company's financial statements.

The Company's headquarters are located in Issaquah, Washington. Additionally, the Company maintains regional buying and administrative offices, operates regional cross-docking facilities (depots) for the consolidation and distribution of certain shipments to the warehouses, and operates various processing, packaging, and other facilities to support ancillary and other businesses.

In addition to its broad range of high quality, nationally branded and private label merchandise, the Company has enhanced the warehouse club concept to include fresh products (meat, bakery, deli and produce) as well as a number of ancillary businesses, including the following as of December 31, 2004:

ANCILLARY BUSINESSES

	United States	Canada	Other International	Total
Pharmacy	322	46	0	368
Optical Dispensing Centers	321	61	23	405
One-Hour Photo	323	63	28	414
Food Court and Hot Dog Stands	327	63	28	418
Hearing Aid Centers	144	11	0	155
Copy Centers	8	0	0	8
Print Shops	2	0	0	2
Gas Stations	215	3	0	218

MARKET FOR COSTCO COMMON STOCK

Costco Common Stock is quoted on The NASDAQ Stock Market's National Market under the symbol "COST."

The following table sets forth the closing high and low sales prices of Costco Common Stock for the period January 1, 2002 through December 3, 2004. The quotations are as reported in published financial sources.

	Costco Common Stock	
	High	Low
Calendar Quarters—2002		
First Quarter	\$46.32	\$38.92
Second Quarter	43.00	37.59
Third Quarter	39.30	31.85
Fourth Quarter	36.21	27.24
Calendar Quarters—2003		
First Quarter	31.23	28.08
Second Quarter	37.43	30.41
Third Quarter	37.15	28.89
Fourth Quarter	37.29	31.94
Calendar Quarters—2004		
First Quarter	39.94	36.08
Second Quarter	42.89	35.54
Third Quarter	42.42	39.74
Fourth Quarter (through December 3, 2004)	49.74	42.29

On December 3, 2004, the Company had 7,797 stockholders of record.

Participants in the Company's 401(k) plan have purchased more shares of the Company's common stock in their plan accounts than were registered with the Securities and Exchange Commission. The Company received no proceeds from any of these sales. Upon receipt of regulatory approvals, the Company presently intends to make a rescission offer to plan participants who purchased the Company's common stock in 401(k) plan accounts during the preceding twelve months. The Company does not believe that the rescission offer will materially impact its consolidated results of operations, financial position or cash flows.

DIVIDEND POLICY

Under its two revolving credit agreements, Costco is generally permitted to pay dividends in any fiscal year up to an amount equal to fifty percent of its consolidated net income for that fiscal year. On April 28, 2004, Costco declared its first quarterly cash dividend. The first dividend of \$0.10 per share was paid May 31, 2004, to shareholders of record at the close of business on May 10, 2004 and a second dividend of \$0.10 per share was paid August 27, 2004 to shareholders of record at the close of business on July 23, 2004. Subsequent to fiscal year end a dividend of \$0.10 per share was paid November 26, 2004, to shareholders of record at the close of business on November 5, 2004.

Payment of future dividends is subject to declaration by the Board of Directors. Factors considered in determining the size of the dividends are profitability and expected capital needs of the Company. Subject to qualifications stated above, the Company presently expects to pay dividends on a quarterly basis.

EQUITY COMPENSATION PLANS

Information related to the Company's equity compensation plans is incorporated herein by reference to the Proxy Statement. The Proxy Statement will be filed with the Securities and Exchange Commission within 120 days of the end of the Company's fiscal year.

TEN YEAR OPERATING AND FINANCIAL HIGHLIGHTS
(dollars in millions, except per share data)

WAREHOUSES IN OPERATIONS	2004	2003	2002	2001
Beginning of year	397	374	345	313
Openings	20	29	35	39
Closings	—	(6)	(6)	(7)
End of year	417	397	374	345
OPERATING RESULTS				
Revenue				
Net Sales	\$47,146	\$41,693	\$37,993	\$34,137
Membership fees and other	961	853	769	660
Total revenue	48,107	42,546	38,762	34,797
Operating expenses				
Merchandise costs	42,092	37,235	33,983	30,598
Selling, general and administrative expenses	4,598	4,097	3,576	3,129
Preopening expenses	30	37	51	60
Provision for impaired assets and closing costs	1	20	21	18
Operating expenses	46,721	41,389	37,631	33,805
Operating income	1,386	1,157	1,131	992
Other income (expenses)				
Interest expense	(37)	(37)	(29)	(32)
Interest income and other	51	38	36	43
Provision for merger and restructuring expenses	—	—	—	—
Income from continuing operations before income taxes and cumulative effect of accounting change	1,400	1,158	1,138	1,003
Provision for income taxes	518	437	438	401
Income from continuing operations before cumulative effect of accounting change	882	721	700	602
Cumulative effect of accounting change, net of tax	—	—	—	—
Income from continuing operations	882	721	700	602
Discontinued operations:				
Income (loss), net of tax	—	—	—	—
Loss on disposal	—	—	—	—
Net income (loss)	\$ 882	\$ 721	\$ 700	\$ 602
Per Share Data—Diluted				
Income from continuing operations before cumulative effect of accounting change	\$ 1.85	\$ 1.53	\$ 1.48	\$ 1.29
Cumulative effect of accounting change, net of tax	—	—	—	—
Income from continuing operations	1.85	1.53	1.48	1.29
Discontinued operations:				
Income (loss), net of tax	—	—	—	—
Loss on disposal	—	—	—	—
Net income (loss)	\$ 1.85	\$ 1.53	\$ 1.48	\$ 1.29
Shares used in calculation (000's)	485,459	479,326	479,262	475,827
Dividends per share	\$ 0.20	\$ —	\$ —	\$ —
Balance Sheet Data				
Working capital (deficit)	\$ 1,099	\$ 700	\$ 181	\$ (230)
Property and equipment, net	7,264	6,960	6,524	5,827
Total assets	15,093	13,192	11,620	10,090
Short-term debt	22	47	104	195
Long-term debt and capital lease obligations	994	1,290	1,211	859
Stockholders' equity	7,625	6,555	5,694	4,883
SALES INCREASE (DECREASE) FROM PRIOR YEAR				
Total	13%	10%	11%	8%
Comparable units	10%	5%	6%	4%
MEMBERS AT YEAR END (000'S)				
Business (primary cardholders)	4,810	4,636	4,476	4,358
Gold Star	15,018	14,984	14,597	12,737

2000		1999		1998		1997		1996		1995	
292		278		261		252		240		221	
25		21		18		17		20		24	
(4)		(7)		(1)		(8)		(8)		(5)	
313		292		278		261		252		240	
<hr/>											
\$31,621	100.0%	\$26,976	100.0%	\$23,830	100.0%	\$21,484	100.0%	\$19,214	100.0%	\$17,906	100.0%
543	1.7	480	1.8	440	1.8	390	1.8	352	1.8	341	1.9
32,164	101.7	27,456	101.8	24,270	101.8	21,874	101.8	19,566	101.8	18,247	101.9
<hr/>											
28,322	89.6	24,170	89.6	21,380	89.7	19,314	89.9	17,345	90.3	16,226	90.6
2,756	8.7	2,338	8.7	2,070	8.7	1,877	8.7	1,691	8.8	1,556	8.7
42	0.1	31	0.1	27	0.1	27	0.1	29	0.1	25	0.1
7	—	57	0.2	6	—	75	0.4	10	—	7	—
31,127	98.4	26,596	98.6	23,483	98.5	21,293	99.1	19,075	99.2	17,814	99.5
1,037	3.3	860	3.2	787	3.3	581	2.7	491	2.6	433	2.4
<hr/>											
(39)	(0.1)	(45)	(0.2)	(48)	(0.2)	(76)	(0.4)	(78)	(0.4)	(68)	(0.4)
54	0.2	44	0.2	27	0.1	15	0.1	11	—	3	—
—	—	—	—	—	—	—	—	—	—	—	—
<hr/>											
1,052	3.3	859	3.2	766	3.2	520	2.4	424	2.2	368	2.0
421	1.3	344	1.3	306	1.3	208	0.9	175	0.9	151	0.8
<hr/>											
631	2.0	515	1.9	460	1.9	312	1.5	249	1.3	217	1.2
—	—	(118)	(0.4)	—	—	—	—	—	—	—	—
631	2.0	397	1.5	460	1.9	312	1.5	249	1.3	217	1.2
<hr/>											
—	—	—	—	—	—	—	—	—	—	(83)	(0.5)
—	—	—	—	—	—	—	—	—	—	—	—
\$631	2.0%	\$ 397	1.5%	\$ 460	1.9%	\$ 312	1.5%	\$ 249	1.3%	\$ 134	0.7%
<hr/>											
\$ 1.35		\$ 1.11		\$ 1.01		\$ 0.73		\$ 0.61		\$ 0.53	
—		(0.25)		—		—		—		—	
1.35		0.86		1.01		0.73		0.61		0.53	
<hr/>											
—		—		—		—		—		—	
—		—		—		—		—		(0.19)	
\$ 1.35		\$ 0.86		\$ 1.01		\$ 0.73		\$ 0.61		\$ 0.34	
475,737		471,120		463,371		449,336		435,781		447,219	
\$ —		\$ —		\$ —		\$ —		\$ —		\$ —	
<hr/>											
\$ 66		\$ 450		\$ 431		\$ 146		\$ 57		\$ 9	
4,834		3,907		3,395		3,155		2,888		2,535	
8,634		7,505		6,260		5,476		4,912		4,437	
10		—		—		25		60		76	
790		919		930		917		1,229		1,095	
4,240		3,532		2,966		2,468		1,778		1,531	
<hr/>											
17%		13%		11%		12%		7%		11%	
11%		10%		8%		9%		5%		2%	
4,170		3,887		3,676		3,537		3,435		3,318	
10,521		9,535		8,654		7,845		7,076		6,683	

MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS

Certain statements contained in this document constitute forward-looking statements within the meaning of the Private Securities Litigation Reform Act of 1995. For these purposes, forward-looking statements are statements that address activities, events, conditions or developments that the Company expects or anticipates may occur in the future. Such forward-looking statements involve risks and uncertainties that may cause actual events, results or performance to differ materially from those indicated by such statements. These risks and uncertainties include, but are not limited to, domestic and international economic conditions including exchange rates, the effects of competition and regulation, consumer and small business spending patterns and debt levels, conditions affecting the acquisition, development, ownership or use of real estate, actions of vendors, rising costs associated with employees (including health care and workers' compensation costs), geopolitical conditions and other risks identified from time to time in the Company's public statements and reports filed with the Securities and Exchange Commission.

Executive Overview and Selected Consolidated Statements of Income Data (dollars in thousands, except earnings per share)

Overview

Costco operates membership warehouses based on the concept that offering members very low prices on a limited selection of nationally branded and selected private label products in a wide range of merchandise categories will produce high sales volumes and rapid inventory turnover. This rapid inventory turnover, when combined with the operating efficiencies achieved by volume purchasing, efficient distribution and reduced handling of merchandise in no-frills, self-service warehouse facilities, enables Costco to operate profitably at significantly lower gross margins than traditional wholesalers, discount retailers and supermarkets.

Key items for fiscal year 2004 included:

- Net sales increased 13.1% over the prior year, driven by an increase in comparable sales of 10% and the opening of 20 new warehouses;
- Membership fees for fiscal 2004 increased 12.7% to \$961,280 representing new member sign ups at new warehouses opened during the fiscal year, increasing penetration of the Company's Executive Membership program, and continued strong member renewal rates;
- Gross margin (net sales less merchandise costs) improved three basis points as a percent of net sales over the prior year, resulting in part from a fourteen basis point improvement in margin in merchandise and ancillary departments;
- Selling, general and administrative expenses as a percentage of net sales improved eight basis points over the prior year, largely due to higher sales, changes to our health care plans and a flattening of the rising trend in our workers' compensation costs;
- Net income for fiscal 2004 increased 22.4% to \$882,393, or \$1.85 per diluted share; and
- For the first time, the Board of Directors declared a quarterly cash dividend, and the Company issued quarterly dividends in the third and fourth quarters of \$0.10 per share.

SELECTED CONSOLIDATED STATEMENTS OF INCOME DATA

The table below presents selected operational data, the percentage relationship between net sales and major categories in the Consolidated Statements of Income and the percentage change in the dollar amounts of each of the items.

	Percent of Net Sales			Percentage Increase/(Decrease) (of dollar amounts)	
	Fiscal 2004	Fiscal 2003	Fiscal 2002	Fiscal 2004 vs. Fiscal 2003	Fiscal 2003 vs. Fiscal 2002
Net sales	100.00%	100.00%	100.00%	13.1%	9.7%
Membership fees	2.04	2.05	2.03	12.7	10.8
Gross margin (a)	10.72	10.69	10.55	13.4	11.2
Selling, general and administrative	9.75	9.83	9.41	12.2	14.6
Preopening expenses	0.07	0.09	0.13	(16.9)	(28.5)
Provision for impaired assets and closing costs, net	—	0.05	0.06	(94.9)	(7.4)
Operating income	2.94	2.77	2.98	19.8	2.2
Interest expense	(0.08)	(0.08)	(0.08)	(0.7)	26.9
Interest income and other	0.11	0.09	0.09	34.0	7.8
Income before income taxes	2.97	2.78	2.99	20.9	1.8
Provision for income taxes	1.10	1.05	1.15	18.5	(0.2)
Net Income	1.87%	1.73%	1.84%	22.4%	3.0%

(a) Defined as net sales less merchandise costs.

Comparison of Fiscal 2004 (52 weeks) and Fiscal 2003 (52 weeks): (dollars in thousands, except earnings per share)

Net Income

Net income for fiscal 2004 increased 22.4% to \$882,393, or \$1.85 per diluted share, from \$721,000, or \$1.53 per diluted share during fiscal year 2003.

Net Sales

Net sales increased 13.1% to \$47,145,712 in fiscal 2004 from \$41,692,699 in fiscal 2003. Approximately 78% of the increase was due to an increase in comparable warehouse sales, that is sales in warehouses open for at least a year. The balance of the increase was due to opening 20 new warehouses during fiscal 2004 and a net of 23 new warehouses (29 opened, 6 closed) during fiscal 2003, a portion of which is not included in comparable warehouse sales. Net sales were reduced by the implementation of Emerging Issues Task Force (EITF) Issue No. 03-10, "Application of Issue No. 02-16, "Accounting by a Customer (Including a Reseller) for Certain Consideration Received from a Vendor," by Resellers to Sales Incentives Offered to Consumers by Manufacturers," which was effective at the beginning of the Company's fiscal 2004 third quarter. EITF 03-10, which primarily impacts the Company's vendor coupon programs, reduces net sales and merchandise costs by an equal amount and does not affect the Company's consolidated gross margin or net income. Had EITF 03-10 been in effect for the comparable periods in fiscal 2003, the net sales increase in fiscal 2004 would have been 13.8%. (See Recently Issued Accounting Pronouncements, EITF 03-10.)

For fiscal 2004, comparable sales increased 10% from fiscal 2003. Had EITF 03-10 been in effect for the comparable periods in fiscal 2003, the comparable sales increase for fiscal 2004 would have been 11%.

Changes in prices of merchandise did not materially affect the sales increases, with the exception of gasoline, where price increases accounted for a sales increase of approximately 70 basis points. In addition, due to the weaker U.S. dollar throughout fiscal 2004 as compared to fiscal 2003, translation of foreign sales into U.S. dollars contributed to the increase in sales, accounting for a comparable sales increase of approximately 190 basis points year-over-year. Sales were also positively impacted by the supermarket strikes in Southern California during the first half of the Company's fiscal year. The positive impact to sales for the entire fiscal year was estimated to be 35 to 50 basis points.

Membership Fees

Membership fees increased 12.7% to \$961,280, or 2.04% of net sales, in fiscal 2004 from \$852,853, or 2.05% of net sales, in fiscal 2003. This increase was primarily due to additional membership sign-ups at the 20 new warehouses opened in fiscal 2004; increased penetration of the Company's Executive membership, including the rollout of the program into Canada, which began in the first quarter of fiscal 2004; and high overall member renewal rates consistent with recent years, currently at 86%.

Gross Margin

Gross margin increased 13.4% to \$5,053,696, or 10.72% of net sales, in fiscal 2004 from \$4,457,316, or 10.69% of net sales, in fiscal 2003. The three basis point increase, as a percent of net sales, reflected a 14 basis point increase in gross margin in the Company's merchandise departments, helped by strong year-over-year gross margin gains in the Company's ancillary business operations, particularly gasoline and pharmacy. Year-over-year gross margin, as a percentage of net sales, was also positively impacted by the implementation of EITF 03-10, whereby net sales and merchandise costs were reduced, resulting in an eight basis point increase. The year-over-year gross margin percentage was reduced by 12 basis points due to the increased rewards related to the Executive Membership Two-Percent Reward Program, resulting from an increase in the penetration of the Executive Member program.

The gross margin figures reflect accounting for most U.S. merchandise inventories on the last-in, first-out (LIFO) method. Fiscal 2004 included a \$6,090 LIFO charge (increase in merchandise costs), while fiscal 2003 included a \$19,650 LIFO credit (reduction in merchandise costs). The impact of the LIFO adjustment on a year-over-year basis negatively impacted margin by an additional six basis points. If all inventories had been valued using the first-in, first-out (FIFO) method, inventories would have been lower by \$13,410 and \$19,500 at August 29, 2004 and August 31, 2003, respectively.

Selling, General and Administrative Expenses

Selling, general and administrative (SG&A) expenses as a percent of net sales decreased to 9.75% during fiscal 2004 from 9.83% during fiscal 2003. Had EITF 03-10 been in effect in fiscal 2003, SG&A expenses as a percent to net sales would have shown additional improvement of seven basis points in fiscal 2004.

For fiscal 2004, warehouse and central operating costs positively impacted SG&A comparisons year-over-year by approximately 21 basis points, primarily due to increased expense leverage of warehouse payroll, benefits (primarily health care), utility and workers' compensation costs. During the latter half of fiscal 2004, the Company implemented changes to its employee healthcare plans that reduced its overall healthcare costs, primarily in the fourth quarter. This improvement was partially offset by the seven basis point increase resulting from the adoption of EITF 03-10, a two basis point increase in expense related to the establishment of additional insurance liabilities resulting from financial difficulties being experienced by one of the Company's third-party insurance providers, and an increase in stock-based compensation costs following the Company's prospective adoption of Statement of Financial Accounting Standards (SFAS) No. 123, "Accounting for Stock Based Compensation," during fiscal 2003, of four basis points.

Preopening Expenses

Preopening expenses totaled \$30,451, or 0.07% of net sales, during fiscal 2004 compared to \$36,643, or 0.09% of net sales, during fiscal 2003. This reduction was due to fewer warehouse openings. During fiscal 2004, the Company opened 20 new warehouses compared to 29 new warehouses (including 5 relocations) during fiscal 2003. Pre-opening expenses also include costs related to remodels and expanded ancillary operations at existing warehouses.

Provision for Impaired Assets and Closing Costs, net

The net provision for impaired assets and closing costs was \$1,000 in fiscal 2004, compared to \$19,500 in fiscal 2003. The provision includes costs related to impairment of long-lived assets, future lease obligations of warehouses that have been relocated to new facilities, and losses or gains resulting from the sale of real property. The provision for fiscal 2004 included charges of \$16,548 for warehouse closing expenses that were offset by gains of \$15,548 on the sale of real property. The provision for fiscal 2003 included charges of \$11,836 for warehouse closing expenses, \$4,697 for impairment of long-lived assets and \$2,967 for net losses on the sale of real property. At August 29, 2004, the reserve for warehouse closing costs was \$10,367, of which \$9,184 related to future lease obligations. This compares to a reserve for warehouse closing costs of \$8,609 at August 31, 2003, of which \$7,833 related to future lease obligations.

Interest Expense

Interest expense totaled \$36,651 in fiscal 2004, compared to \$36,920 in fiscal 2003. Interest expense in both fiscal 2004 and 2003 includes interest on the 3½% Zero Coupon Notes, 7⅞% and 5½% Senior Notes and on balances outstanding under the Company's bank credit facilities and promissory notes. The decrease was primarily a result of the Company's reduction in short-term borrowings, principally related to its foreign subsidiaries. This decrease was substantially offset by increases in interest rates on the Senior Notes due to interest rate swap agreements converting the interest rate from fixed to floating.

Interest Income and Other

Interest income and other totaled \$51,627 in fiscal 2004, compared to \$38,525 in fiscal 2003. The increase primarily reflects greater interest earned on higher cash and cash equivalents balances and short-term investments. In addition, a reduction in the expense to record minority interest in the earnings of foreign subsidiaries was reported in fiscal 2004 as the Company increased its ownership in Costco Wholesale UK Limited to 100%.

Provision for Income Taxes

The effective income tax rate on earnings was 37% in fiscal 2004 and 37.75% in fiscal 2003. The decrease in the effective income tax rate is primarily attributable to lower statutory income tax rates for foreign operations and one-time benefits associated with certain tax planning strategies.

Comparison of Fiscal 2003 (52 weeks) and Fiscal 2002 (52 weeks): (dollars in thousands, except earnings per share)

Net Income

Net income for fiscal 2003 increased 3.0% to \$721,000, or \$1.53 per diluted share, from \$699,983, or \$1.48 per diluted share during fiscal year 2002.

Net Sales

Net sales increased 9.7% to \$41,692,699 in fiscal 2003 from \$37,993,093 in fiscal 2002. Approximately 55% of the increase was due to an increase in comparable warehouse sales, that is sales in warehouses open for at

least a year, and approximately 45% of the increase was due to opening a net of 23 new warehouses (29 opened, 6 closed) during fiscal 2003 and a net of 29 new warehouses (35 opened, 6 closed) during fiscal 2002, a portion of which is not included in comparable warehouse sales. With the exception of price increases in gasoline, which accounted for a comparable sales increase of approximately 70 basis points, changes in prices of merchandise did not materially contribute to sales increases. In addition, due to the weaker U.S. dollar in fiscal 2003 as compared to fiscal 2002, translation of foreign sales into U.S. dollars contributed to the increase in sales, accounting for a comparable sales increase of approximately one percent year-over-year. Comparable sales increased at a five percent annual rate in fiscal 2003 compared to a six percent annual rate during fiscal 2002.

Membership fees

Membership fees increased 10.8% to \$852,853, or 2.05% of net sales, in fiscal 2003 from \$769,406, or 2.03% of net sales, in fiscal 2002. This increase was primarily due to additional membership sign-ups at the 23 net new warehouses opened in fiscal 2003, and increased penetration of the Company's Executive Membership. Overall, member renewal rates remained consistent with the prior year, currently at 86%.

Gross Margin

Gross margin (defined as net sales minus merchandise costs) increased 11.2% to \$4,457,316, or 10.69% of net sales, in fiscal 2003 from \$4,009,972, or 10.55% of net sales, in fiscal 2002. The increase in gross margin as a percentage of net sales reflects merchandise gross margin improvement within the Company's ancillary warehouse businesses and international operations accounting for increases of 15 and eight basis points, respectively. Additionally, increased rewards related to the Executive Membership Two-Percent Reward Program reduced gross margin by seven basis points. The gross margin figures reflect accounting for most U.S. merchandise inventories on the last-in, first-out (LIFO) method. The effect of the LIFO adjustment for fiscal 2003 was to increase gross margin by \$19,650, compared to a gross margin increase of \$13,500 in fiscal 2002. If all inventories had been valued using the first-in, first-out (FIFO) method, inventories would have been lower by \$19,500 at August 31, 2003 and higher by \$150 at September 1, 2002.

Selling, General and Administrative Expenses

Selling, general and administrative expenses as a percent of net sales increased to 9.83% during fiscal 2003 from 9.41% during fiscal 2002. The increase in selling, general and administrative expenses as a percent of net sales was primarily due to increases in employee healthcare, workers' compensation (primarily in the state of California) and salary costs within the Company's domestic operations. International expenses also increased, accounting for approximately seven basis points of the 42 basis points year-over-year increase.

Preopening Expenses

Preopening expenses totaled \$36,643, or 0.09% of net sales, during fiscal 2003, compared to \$51,257, or 0.13% of net sales, during fiscal 2002. During fiscal 2003, the Company opened 29 new warehouses (including five relocations) compared to 35 new warehouses (including six relocations) during fiscal 2002. Pre-opening expenses also include costs related to remodels and expanded ancillary operations at existing warehouses.

Provision for Impaired Assets and Closing Costs, net

The net provision for impaired assets and closing costs was \$19,500 in fiscal 2003 compared to \$21,050 in fiscal 2002. The provision includes costs related to impairment of long-lived assets, future lease obligations of warehouses that have been relocated to new facilities and any losses or gains resulting from the sale of real property. The provision for fiscal 2003 included charges of \$11,836 for warehouse closing expenses, \$4,697 for impairment of long-lived assets and \$2,967 for net losses on the sale of real property. The fiscal 2002 provision included charges of \$13,683 for warehouse closing expenses and \$7,765 for Canadian administrative reorganization, which were offset by \$398 of net gains on the sale of real property. At August 31, 2003 the reserve for

warehouse closing costs was \$8,609, of which \$7,833 related to future lease obligations. This compares to a reserve for warehouse closing costs of \$11,845 at September 1, 2002, of which \$10,395 related to future lease obligations.

Interest Expense

Interest expense totaled \$36,920 in fiscal 2003, compared to \$29,096 in fiscal 2002. Interest expense in fiscal 2003 includes interest on the 3 1/2% Zero Coupon Notes, 7 1/8% and 5 1/2% Senior Notes and on balances outstanding under the Company's bank credit facilities and promissory notes. The increase is primarily related to the reduction in interest capitalized related to warehouse construction, as the overall cost of projects under construction was lower than in fiscal 2002. The increase was also attributed to the Company's issuance of \$300,000 5 1/2% Senior Notes in March 2002, which were simultaneously swapped to a floating interest rate. This increase was partially offset by an interest rate reduction in the Company's \$300,000 7 1/8% Senior Notes, resulting from interest rate swap agreements entered into effective November 13, 2001, converting the interest rate from fixed to floating, and to the fact that the Company had little interest expense related to borrowings under its commercial paper program in fiscal 2003.

Interest Income and Other

Interest income and other totaled \$38,525 in fiscal 2003, compared to \$35,745 in fiscal 2002. The increase primarily reflects greater interest earned on higher cash and cash equivalents balances on hand throughout fiscal 2003, as compared to fiscal 2002, which was partially offset by an increase in the expense to record the minority interest in earnings of foreign subsidiaries.

Provision for Income Taxes

The effective income tax rate on earnings was 37.75% in fiscal 2003 and 38.50% in fiscal 2002. The decrease in the effective income tax rate, year-over-year, is primarily attributable to lower statutory income tax rates for foreign operations.

Liquidity and Capital Resources (dollars in thousands, except per share amounts)

Cash Flows

Cash flow generated from warehouse operations provides a significant source of liquidity. Net cash provided by operating activities totaled \$2,098,783 in fiscal 2004 compared to \$1,507,208 in fiscal 2003. The increase of \$591,575 is primarily a result of an increase in the change in receivables, other current assets, deferred income and accrued and other current liabilities of \$507,860, due primarily to the collection of an operating tax receivable and increases in the workers' compensation accrual, income taxes payable, executive membership two-percent reward accrual and deferred membership income in fiscal 2004 compared to fiscal 2003. In addition, the increase in net income of \$161,393 contributed to the increase in cash provided by operating activities.

The primary investing activity continues to be the purchase of property and equipment and the construction of facilities related to the Company's warehouse expansion and remodel projects. Net cash used in investing activities totaled \$1,048,481 in fiscal 2004 compared to \$790,588 in fiscal 2003, an increase of \$257,893. The increase in investing activities primarily relates to net purchases of short-term investments of \$303,945 and the purchase of the remaining 20% minority interest in Costco Wholesale UK Limited of \$95,153, which was partially offset by a reduction in the acquisition of property and equipment and the construction of facilities for new and remodeled warehouses of \$105,045 (from \$810,665 to \$705,620) between fiscal 2003 and fiscal 2004, as new warehouse openings decreased year-over-year from 29 (including five relocated warehouses) in fiscal 2003 to 20 in fiscal 2004.

Net cash provided by financing activities totaled \$209,569 in fiscal 2004 compared to net cash used of \$1,428 in fiscal 2003. The increase of \$210,997 primarily resulted from an increase in bank checks outstanding of \$243,890 and the increase in proceeds received from the exercise of stock options of \$90,077, which were offset by the payment of cash dividends in fiscal 2004 of \$92,137 and from the reduction in the issuance of long-term debt of \$59,424 in fiscal 2003 to no additional issuances of long-term debt in the current fiscal year.

Dividends

Costco's Board of Directors declared two quarterly cash dividends of \$0.10 per share in fiscal 2004. The first quarterly cash dividend of \$0.10 per share, in the amount of \$45,939, was paid May 31, 2004 to shareholders of record at the close of business on May 10, 2004. The second quarterly cash dividend of \$0.10 per share, in the amount of \$46,198, was paid August 27, 2004, to shareholders of record at the close of business on July 23, 2004.

Contractual Obligations

The Company's commitment to make future payments under contractual obligations was as follows, as of August 29, 2004.

Contractual obligations	Payments Due by Period				
	Total	Less than 1 year	1 to 3 years	4 to 5 years	After 5 years
Long-term debt(1)	\$1,656,393(2)	\$ 339,441	\$336,632	\$ 62,081	\$ 918,239(2)
Capital lease obligations	5,449	1,451	1,117	1,115	1,766
Operating leases(3)	1,574,778	110,616	212,734	190,401	1,061,027
Purchase obligations (merchandise)(4)	3,509,786	3,153,157	356,629	—	—
Purchase obligations (building, equipment, services and other)(5)	232,212	213,823	16,556	1,833	—
Other(6)	6,235	476	594	418	4,747
Total	<u>\$6,984,853</u>	<u>\$3,818,964</u>	<u>\$924,262</u>	<u>\$255,848</u>	<u>\$1,985,779</u>

- (1) Amounts include contractual interest payments.
- (2) The amount includes interest accreted to maturity for the Company's Zero Coupon 3½% Convertible Subordinated Notes due August 2017, totaling \$851,648. The consolidated balance sheet as of August 29, 2004 reflects a balance outstanding of \$543,025.
- (3) Operating lease obligations have been reduced by \$148,339 to reflect sub-lease income.
- (4) Includes open merchandise purchase orders at fiscal year end, including those supported by letters of credit.
- (5) The amounts presented above as purchase obligations include an analysis of all known contracts with the exception of minor outsourced services negotiated at the individual warehouse level that are not significant and generally contain clauses allowing for cancellation without significant penalty.
- (6) Primarily consists of asset retirement obligations.

Expansion Plans

Costco's primary requirement for capital is the financing of the land, building and equipment costs for new warehouses plus the costs of initial warehouse operations and working capital requirements, as well as additional capital for international expansion.

While there can be no assurance that current expectations will be realized, and plans are subject to change upon further review, it is management's current intention to spend approximately \$900,000 to \$1,000,000 during fiscal 2005 in the United States and Canada for real estate, construction, remodeling and equipment for warehouse clubs and related operations; and approximately \$100,000 to \$150,000 for international expansion, including the United Kingdom, Asia, Mexico and other potential ventures. These expenditures are expected to be financed with a combination of cash provided from operations and the use of cash and cash equivalents and short-term investments.

Expansion plans for the United States and Canada during fiscal 2005 are to open approximately 30 new warehouse clubs inclusive of seven relocations to larger and better-located warehouses. The Company expects to

continue its review of expansion plans in its international operations, including the United Kingdom and Asia, along with other international markets. At present, the Company is planning to open two additional warehouses in the U.K and one additional warehouse in both the Taiwan and Japan markets during fiscal 2005. Costco and its Mexico-based joint venture partner, Controladora Comercial Mexicana, each own a 50% interest in Costco Mexico. Costco Mexico plans to open two to three new warehouse clubs during fiscal 2005.

Additional Equity Investments in Subsidiary

On October 3, 2003, the Company acquired from Carrefour Nederland B.V. its 20% equity interest in Costco Wholesale UK Limited for cash of \$95,153, bringing Costco's ownership in Costco Wholesale UK Limited to 100%.

Bank Credit Facilities and Commercial Paper Programs (all amounts stated in thousands of US dollars)

The Company has a \$500,000 commercial paper program supported by a \$300,000 bank credit facility with a group of ten banks, of which \$150,000 expired on November 9, 2004 and \$150,000 expires on November 15, 2005. At August 29, 2004, no amounts were outstanding under the commercial paper program and no amounts were outstanding under the credit facility. The Company presently does not plan to renew the \$150,000 portion of the credit facility that expired on November 9, 2004.

A wholly-owned Canadian subsidiary has a \$152,000 commercial paper program supported by a \$46,000 bank credit facility with a Canadian bank, that is guaranteed by the Company and expires in March 2005. At August 29, 2004, no amounts were outstanding under the Canadian commercial paper program or the bank credit facility.

The Company has agreed to limit the combined amount outstanding under the U.S. and Canadian commercial paper programs to the combined amounts of the supporting bank credit facilities, which are \$346,000 at August 29, 2004, decreased to \$196,000 on November 9, 2004.

The Company's wholly-owned Japanese subsidiary has a short-term \$27,400 bank line of credit that originally expired in November 2004. Subsequent to the Company's fiscal year end, the bank line of credit was extended through February 10, 2005. At August 29, 2004, no amounts were outstanding under the line of credit.

The Company's Korean subsidiary has a short-term \$10,400 bank line of credit, which expires in January 2005. At August 29, 2004, no amounts were outstanding under the line of credit.

The Company's wholly-owned UK subsidiary has a \$108,000 bank revolving credit facility expiring in February 2007 and a \$63,000 bank overdraft facility renewable on a yearly basis in March. At August 29, 2004, \$21,595 was outstanding under the revolving credit facility with an applicable interest rate of 5.285% and no amounts were outstanding under the bank overdraft facility.

Letters of Credit

The Company has letter of credit facilities (for commercial and standby letters of credit), totaling approximately \$338,000. The outstanding commitments under these facilities at August 29, 2004 totaled approximately \$166,800, including approximately \$52,900 in standby letters of credit.

Financing Activities

The Company's 7 1/4% Senior Notes of \$304,350 at August 29, 2004 are due on June 15, 2005. The Company plans to repay the 7 1/4% Senior Notes from its cash and cash equivalents and short-term investment balances, which totaled \$3,129,882 at August 29, 2004.

In April 2003, the Company's wholly-owned Japanese subsidiary issued promissory notes bearing interest at 0.92% in the aggregate amount of approximately \$36,576, through a private placement. Interest is payable semi-annually and principal is due on April 26, 2010.

In November 2002, the Company's wholly-owned Japanese subsidiary issued promissory notes bearing interest at 0.88% in the aggregate amount of approximately \$27,432, through a private placement. Interest is payable semi-annually and principal is due on November 7, 2009. The Company guarantees all of the promissory notes issued by its wholly-owned Japanese subsidiary.

In March 2002, the Company issued \$300,000 of 5 1/2% Senior Notes due March 15, 2007. Interest is payable semi-annually. Simultaneous with the issuance of the Senior Notes, the Company entered into interest rate swap agreements converting the interest from fixed to floating.

In February 1996, the Company filed with the Securities and Exchange Commission a shelf registration statement for \$500,000 of senior debt securities. On October 23, 2001, additional debt securities of \$100,000 were registered. The \$300,000 of 5 1/2% Senior Notes issued in March 2002 reduced the amount of registered securities available for future issuance to \$300,000.

Derivatives

The Company has limited involvement with derivative financial instruments and uses them only to manage well-defined interest rate and foreign exchange risks. Forward foreign exchange contracts are used to hedge the impact of fluctuations of foreign exchange on inventory purchases and typically have very short terms. The aggregate amount of foreign exchange contracts outstanding at August 29, 2004 was not material. The only significant derivative instruments the Company holds are interest rate swaps, which the Company uses to manage the interest rate risk associated with its borrowings and to manage the Company's mix of fixed-rate and variable-rate debt. As of August 29, 2004, the Company had "fixed-to-floating" interest rate swaps with an aggregate notional amount of \$600,000 and an aggregate fair value of \$25,754, which is recorded in other assets on the Company's consolidated balance sheet. These swaps were entered into effective November 13, 2001, and March 25, 2002, and are designated and qualify as fair value hedges of the Company's \$300,000 7 1/8% Senior Notes and the Company's \$300,000 5 1/2% Senior Notes, respectively. As the terms of the swaps match those of the underlying hedged debt, the changes in the fair value of these swaps are offset by corresponding changes in the carrying amount of the hedged debt and result in no net earnings impact.

Off-Balance Sheet Arrangements

The Company has no off-balance sheet arrangements that have had or are reasonably likely to have a material current or future effect on the Company's financial condition or consolidated financial statements.

Stock Repurchase Program

On November 30, 2001, the Company's Board of Directors approved a stock repurchase program, authorizing the repurchase of up to \$500,000 of Costco Common Stock through November 30, 2004. Under the program, the Company could repurchase shares at any time in the open market or in private transactions as market conditions warrant. The repurchased shares would constitute authorized, but non-issued shares and would be used for general corporate purposes, including stock option grants under stock option programs. On October 25, 2004, the Board of Directors renewed the program for another three years. To date, no shares have been repurchased under either program.

Critical Accounting Policies

The preparation of the Company's financial statements requires that management make estimates and judgments that affect the financial position and results of operations. Management continues to review its accounting policies and evaluate its estimates, including those related to revenue recognition, merchandise inventory, impairment of long-lived assets and warehouse closing costs and insurance/self-insurance liabilities. The Company bases its estimates on historical experience and on other assumptions that management believes to be reasonable under the present circumstances.

Revenue Recognition

The Company recognizes sales, net of estimated returns, at the time customers take possession of merchandise or receive services. When the Company collects payment from customers prior to the transfer of ownership of merchandise or the performance of services, the amount received is recorded as deferred revenue on the consolidated balance sheets until the sale or service is completed. The Company provides for estimated sales returns based on historical returns levels.

Merchandise Inventories

Merchandise inventories are valued at the lower of cost or market as determined primarily by the retail method of accounting and are stated using the last-in, first-out (LIFO) method for substantially all U.S. merchandise inventories. Merchandise inventories for all foreign operations are primarily valued by the retail method of accounting, and are stated using the first-in, first-out (FIFO) method. The Company believes the LIFO method more fairly presents the results of operations by more closely matching current costs with current revenues. The Company records an adjustment each quarter, if necessary, for the expected annual effect of inflation, and these estimates are adjusted to actual results determined at year-end. The Company considers in its calculation of the LIFO cost the estimated net realizable value of inventory in those inventory pools where deflation exists and records a write down of inventory where estimated net realizable value is less than LIFO inventory.

The Company provides for estimated inventory losses between physical inventory counts on the basis of a percentage of sales. The provision is adjusted periodically to reflect the trend of the actual physical inventory count results, which generally occur in the second and fourth fiscal quarters.

Inventory cost, where appropriate, is reduced by estimates of vendor rebates when earned or as the Company progresses towards earning those rebates provided they are probable and reasonably estimable. Other consideration received from vendors is generally recorded as a reduction of merchandise costs upon completion of contractual milestones, terms of agreement, or other systematic and rational approach.

Impairment of long-lived assets and warehouse closing costs

The Company periodically evaluates its long-lived assets for indicators of impairment. Management's judgments are based on market and operational conditions at the present time. Future events could cause management to conclude that impairment factors exist, requiring an adjustment of these assets to their then-current fair market value.

The Company provides estimates for warehouse closing costs when it is appropriate to do so based on the applicable accounting principles generally accepted in the United States. Future circumstances may result in the Company's actual future closing costs or the amount recognized upon the sale of the property to differ substantially from the original estimates.

Insurance/Self Insurance Liabilities

The Company uses a combination of insurance and self-insurance mechanisms to provide for the potential liabilities for workers' compensation, general liability, property insurance, director and officers' liability, vehicle liability and employee health care benefits. Liabilities associated with the risks that are retained by the Company are not discounted and are estimated, in part, by considering historical claims experience and outside expertise, demographic factors, severity factors and other actuarial assumptions. The estimated accruals for these liabilities could be significantly affected if future occurrences and claims differ from these assumptions and historical trends.

Recent Accounting Pronouncements

In March 2004, the Financial Accounting Standards Board's (FASB) Emerging Issues Task Force (EITF) reached a consensus on EITF Issue No. 03-1, "The Meaning of Other-Than-Temporary Impairment and Its Application to Certain Investments," (EITF 03-1). The guidance prescribes a three-step model for determining

whether an investment is other-than-temporarily impaired and requires disclosures about unrealized losses on investments. The accounting guidance is effective for reporting periods beginning after June 15, 2004, while the disclosure requirements are effective for annual reporting periods ending after June 15, 2004. In September 2004, the FASB issued FASB Staff Position EITF 03-1-1, "Effective Date of Paragraphs 10-20 of EITF Issue No. 03-1 'The Meaning of Other-Than-Temporary Impairment and Its Application to Certain Investments,'" (FSP EITF 03-01-1). FSP EITF 03-1-1 delays the effective date for the measurement and recognition guidance contained in paragraphs 10-20 of EITF Issue 03-01. During the period of the delay, FSP EITF 03-1-1 states that companies should continue to apply relevant "other-than-temporary" guidance. The adoption of EITF 03-1, excluding paragraphs 10-20, did not impact the Company's consolidated financial statements. The Company will assess the impact of paragraphs 10-20 of EITF 03-1 once the guidance has been finalized.

In December 2003, the FASB issued Interpretation No. 46 (revised December 2003), "Consolidation of Variable Interest Entities" (FIN 46R), which addresses how a business enterprise should evaluate whether it has a controlling financial interest in an entity through means other than voting rights and accordingly should consolidate the entity. In general, a variable interest entity is a corporation, partnership, trust, or any other legal structure used for business purposes that either does not have equity investors with voting rights or has equity investors that do not provide sufficient financial resources for the entity to support its activities. FIN 46R requires a variable interest entity to be consolidated by a company if that company is subject to a majority of the risk of loss from the variable interest entity's activities or entitled to receive a majority of the entity's residual returns or both. FIN 46R replaces FASB Interpretation No. 46, "Consolidation of Variable Interest Entities," which was issued in January 2003 and revised the implementation date to the first fiscal period ending after March 15, 2004, with the exception of special purpose entities. The adoption of this interpretation did not have a material impact on the Company's consolidated financial statements.

In November 2003, the EITF reached consensus on Issue No. 03-10, "Application of Issue No. 02-16 by Resellers to Sales Incentives Offered to Consumers by Manufacturers," with respect to determining if consideration received by a reseller from a vendor that is reimbursed by the vendor for honoring the vendor's sale incentives offered directly to consumers should be recorded as a reduction in sales. These rules apply to transactions entered into by consumers in fiscal periods beginning after November 25, 2003 and, therefore, apply to such transactions starting with the Company's fiscal third quarter of 2004, which began February 16, 2004. The adoption of EITF 03-10 did not affect the Company's consolidated gross profit or net income, but did result in a reduction of both net sales and merchandise costs by an equal amount. For fiscal 2004, net sales and merchandise costs have been reduced by \$334,065. Had the Company's comparable periods in fiscal 2003 and 2002 been reported under EITF 03-10 guidance, the sales and cost of sales would have been reduced by \$282,288 and \$248,155, respectively.

In November 2002, the EITF reached consensus on certain issues discussed in Issue No. 02-16, "Accounting by a Customer (Including a Reseller) for Certain Consideration Received from a Vendor," with respect to determining how a reseller should characterize consideration received from a vendor and when to recognize and how to measure that consideration in its income statement. Requirements for recognizing volume-based rebates are effective for arrangements entered into or modified after November 21, 2002 and resellers with other supplier payments should generally apply the new rules prospectively for agreements entered into or modified after December 31, 2002. The adoption of this consensus by the Company in fiscal 2003 did not have a significant impact on the Company on an annual basis, but resulted in a change in the timing for the recognition of some vendor allowances for certain agreements entered into subsequent to December 31, 2002 and extends the recognition time frame beyond that which was in effect for similar contracts entered into prior to December 31, 2002. Net income for fiscal 2004 was negatively impacted by approximately \$2,808 (after-tax) due to the adoption of EITF 02-16.

Quantitative and Qualitative Disclosures About Market Risk

The Company is exposed to financial market risk resulting from changes in interest and foreign currency rates. As a policy, the Company does not engage in speculative or leveraged transactions, nor hold or issue financial instruments for trading purposes.

The nature and amount of the Company's long and short-term debt can be expected to vary as a result of future business requirements, market conditions and other factors. As of August 29, 2004, the Company's fixed rate long-term debt includes its \$851,648 principal amount at maturity Zero Coupon Subordinated Notes and additional notes and capital lease obligations totaling \$130,561. The Company's debt also includes \$300,000 7 1/2% Senior Notes and \$300,000 5 1/2% Senior Notes. The Company has entered into "fixed-to-floating" interest rate swaps on the Senior Notes, effectively converting these fixed interest rate securities to variable rate securities. Fluctuations in interest rates may affect the fair value of the fixed rate debt and may affect the interest expense related to the variable rate debt.

The Company holds interest-bearing instruments that are classified as cash and cash equivalents and short-term investments. Short-term investments generally have a maturity of three months to five years from the purchase date. Investments with maturities beyond one year may be classified as short-term based on their highly liquid nature and because such marketable securities represent the investment of cash that is available for current operations. As the majority of these instruments are of a short-term nature, if interest rates were to increase or decrease immediately, there is no material risk of a valuation adjustment related to these instruments. For those instruments that are classified as available for sale, the unrealized gains or losses related to fluctuations in interest rates are reflected in other accumulated comprehensive income or loss. Based on the Company's cash and cash equivalents and short-term investments balances at August 29, 2004, a 100 basis point increase or decrease in interest rates would result in an increase or decrease of approximately \$27,000 to interest income (pre-tax) on an annual basis.

Most foreign currency transactions have been conducted in local currencies, limiting the Company's exposure to changes in currency rates. The Company periodically enters into short-term forward foreign exchange contracts to hedge the impact of fluctuations in foreign currency rates on inventory purchases. The fair value of foreign exchange contracts outstanding at August 29, 2004 was not material to the Company's results of operations or its financial position.

Controls and Procedures

The Company carried out an evaluation as of August 29, 2004, under the supervision and with the participation of the Company's management, including the Chief Executive Officer and Chief Financial Officer, of the effectiveness of the design and operation of its disclosure controls and procedures pursuant to Exchange Act Rule 13a-15(e) and 15d-15(e). Based upon that evaluation, the Chief Executive Officer and the Chief Financial Officer concluded that the Company's disclosure controls and procedures are effective to timely alert them to any material information relating to the Company (including its consolidated subsidiaries) that must be included in the Company's periodic Securities and Exchange Commission filings. There have been no significant changes in the Company's internal controls or in other factors that could significantly affect internal controls subsequent to their evaluation.

At the end of fiscal year 2005, Section 404 of the Sarbanes-Oxley Act will require management of the Company to provide in its annual report an assessment of the effectiveness of the Company's internal controls over financial reporting and the Company's independent public accounting firm will be required to attest to management's assessment. The Company is in the process of performing the system and process documentation, evaluation and testing required for management to make this assessment and for the auditors to provide its attestation report. The Company has not completed this process or its assessment, and this process will require significant amounts of management time and resources. In the course of evaluation and testing, management may identify deficiencies that will need to be addressed and remediated.

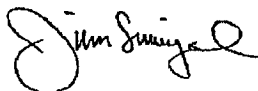
Subsequent Event

Subsequent to fiscal year end the Company experienced some business interruption in its Florida locations due to hurricane damage. With the exception of one warehouse, which closed September 25, 2004 and reopened November 22, 2004, all other warehouses incurred only minor damage and minimal disruption to their operations. Overall, the Company expects to incur losses in the range of \$5,000 to \$7,000 net of insurance recoveries.

CERTIFICATIONS

I, James D. Sinegal, certify that:

- 1) I have reviewed this annual report on Form 10-K of Costco Wholesale Corporation;
- 2) Based on my knowledge, this annual report does not contain any untrue statement of a material fact or omit to state a material fact necessary to make the statements made, in light of the circumstances under which such statements were made, not misleading with respect to the period covered by this annual report;
- 3) Based on my knowledge, the financial statements, and other financial information included in this annual report, fairly present in all material respects the financial condition, results of operations and cash flows of the registrant as of, and for, the periods presented in this annual report;
- 4) The registrant's other certifying officer and I are responsible for establishing and maintaining disclosure controls and procedures (as defined in Exchange Act Rules 13a-15(e) and 15d-15(e)) and internal control over financial reporting (as defined in Exchange Act Rules 13a-15(f) and 15d-15(f)) for the registrant and have:
 - a) Designed such disclosure controls and procedures, or caused such disclosure controls and procedures to be designed under our supervision, to ensure that material information relating to the registrant, including its consolidated subsidiaries, is made known to us by others within those entities, particularly during the period in which this report is being prepared;
 - b) Designed such internal control over financial reporting, or caused such internal control over financial reporting to be designed under our supervision, to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with generally accepted accounting principles;
 - c) Evaluated the effectiveness of the registrant's disclosure controls and procedures and presented in this report our conclusions about the effectiveness of the disclosure controls and procedures, as of the end of the period covered by this report based on such evaluation; and
 - d) Disclosed in this report any change in the registrant's internal control over financial reporting that occurred during the registrant's fiscal 2004 fourth quarter that has materially affected, or is reasonably likely to materially affect, the registrant's internal control over financial reporting; and
- 5) The registrant's other certifying officer and I have disclosed, based on our most recent evaluation of internal control over financial reporting, to the registrant's auditors and the audit committee of registrant's board of directors:
 - a) All significant deficiencies and material weaknesses in the design or operation of internal control over financial reporting which are reasonably likely to adversely affect the registrant's ability to record, process, summarize and report financial information; and
 - b) Any fraud, whether or not material, that involves management or other employees who have a significant role in the registrant's internal controls over financial reporting.



James D. Sinegal
President, Chief Executive Officer

November 12, 2004

CERTIFICATIONS

I, Richard A. Galanti, certify that:

- 1) I have reviewed this annual report on Form 10-K of Costco Wholesale Corporation.
- 2) Based on my knowledge, this annual report does not contain any untrue statement of a material fact or omit to state a material fact necessary to make the statements made, in light of the circumstances under which such statements were made, not misleading with respect to the period covered by this annual report;
- 3) Based on my knowledge, the financial statements, and other financial information included in this annual report, fairly present in all material respects the financial condition, results of operations and cash flows of the registrant as of, and for, the periods presented in this annual report;
- 4) The registrant's other certifying officer and I are responsible for establishing and maintaining disclosure controls and procedures (as defined in Exchange Act Rules 13a-15(e) and 15d-15(e)) and internal control over financial reporting (as defined in Exchange Act Rules 13a-15(f) and 15d-15(f)) for the registrant and have:
 - a) Designed such disclosure controls and procedures, or caused such disclosure controls and procedures to be designed under our supervision, to ensure that material information relating to the registrant, including its consolidated subsidiaries, is made known to us by others within those entities, particularly during the period in which this report is being prepared;
 - b) Designed such internal control over financial reporting, or caused such internal control over financial reporting to be designed under our supervision, to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with generally accepted accounting principles;
 - c) Evaluated the effectiveness of the registrant's disclosure controls and procedures and presented in this report our conclusions about the effectiveness of the disclosure controls and procedures, as of the end of the period covered by this report based on such evaluation; and
 - d) Disclosed in this report any change in the registrant's internal control over financial reporting that occurred during the registrant's fiscal 2004 fourth quarter that has materially affected, or is reasonably likely to materially affect, the registrant's internal control over financial reporting; and
- 5) The registrant's other certifying officer and I have disclosed, based on our most recent evaluation of internal control over financial reporting, to the registrant's auditors and the audit committee of registrant's board of directors:
 - a) All significant deficiencies and material weaknesses in the design or operation of internal control over financial reporting which are reasonably likely to adversely affect the registrant's ability to record, process, summarize and report financial information; and
 - b) Any fraud, whether or not material, that involves management or other employees who have a significant role in the registrant's internal controls over financial reporting.



Richard A. Galanti
Executive Vice President, Chief Financial Officer

November 12, 2004

REPORT OF INDEPENDENT REGISTERED PUBLIC ACCOUNTING FIRM

The Board of Directors and Shareholders
Costco Wholesale Corporation:

We have audited the accompanying consolidated balance sheets of Costco Wholesale Corporation and subsidiaries as of August 29, 2004 and August 31, 2003 and the related consolidated statements of income, stockholders' equity and comprehensive income and cash flows for the 52 weeks ended August 29, 2004, August 31, 2003, and September 1, 2002. These consolidated financial statements are the responsibility of the Company's management. Our responsibility is to express an opinion on these consolidated financial statements based on our audits.

We conducted our audits in accordance with the standards of the Public Company Accounting Oversight Board (United States). Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the consolidated financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the consolidated financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall consolidated financial statement presentation. We believe that our audits provide a reasonable basis for our opinion.

In our opinion, the consolidated financial statements referred to above present fairly, in all material respects, the consolidated financial position of Costco Wholesale Corporation and subsidiaries as of August 29, 2004 and August 31, 2003, and the results of their operations and their cash flows for the 52 weeks ended August 29, 2004, August 31, 2003, and September 1, 2002 in conformity with U.S. generally accepted accounting principles.

As discussed in Note 1 to the consolidated financial statements, effective February 16, 2004, the Company adopted Emerging Issues Task Force Issue No. 03-10, "Application of Issue No. 02-16 by Resellers to Sales Incentives Offered to Consumers by Manufacturers," and effective September 2, 2002, the Company adopted the fair value method of recording stock-based compensation expense in accordance with Statement of Financial Accounting Standards No. 123, "Accounting for Stock-Based Compensation." Additionally, as discussed in Note 1 to the consolidated financial statements, during the fiscal year ended August 31, 2003, the Company adopted Emerging Issues Task Force Issue No. 02-16, "Accounting by a Customer (Including a Reseller) for Certain Consideration Received from a Vendor," based on the specific transition guidance.

KPMG LLP

Seattle, Washington
October 22, 2004

COSTCO WHOLESALE CORPORATION
CONSOLIDATED BALANCE SHEETS
(dollars in thousands except par value)

	August 29, 2004	August 31, 2003
ASSETS		
CURRENT ASSETS		
Cash and cash equivalents	\$ 2,823,135	\$ 1,545,439
Short-term investments	306,747	—
Receivables, net	335,175	556,090
Merchandise inventories	3,643,585	3,339,428
Other current assets	160,457	270,581
Total current assets	<u>7,269,099</u>	<u>5,711,538</u>
PROPERTY AND EQUIPMENT		
Land	2,284,574	2,173,685
Buildings, leaseholds and land improvements	5,212,295	4,831,236
Equipment and fixtures	1,974,995	1,846,324
Construction in progress	132,180	154,181
	9,604,044	9,005,426
Less accumulated depreciation and amortization	<u>(2,340,347)</u>	<u>(2,045,418)</u>
Net property and equipment	7,263,697	6,960,008
OTHER ASSETS	559,752	520,142
	<u>\$15,092,548</u>	<u>\$13,191,688</u>
LIABILITIES AND STOCKHOLDERS' EQUITY		
CURRENT LIABILITIES		
Short-term borrowings	\$ 21,595	\$ 47,421
Accounts payable	3,600,200	3,131,320
Accrued salaries and benefits	904,209	734,261
Accrued sales and other taxes	223,009	207,392
Deferred membership income	453,881	401,357
Current portion long-term debt	305,594	7,051
Other current liabilities	662,062	482,305
Total current liabilities	6,170,550	5,011,107
LONG-TERM DEBT, excluding current portion	993,746	1,289,649
DEFERRED INCOME TAXES AND OTHER LIABILITIES	244,176	209,835
Total liabilities	<u>7,408,472</u>	<u>6,510,591</u>
COMMITMENTS AND CONTINGENCIES		
MINORITY INTEREST	59,266	126,117
STOCKHOLDERS' EQUITY		
Preferred stock \$.005 par value; 100,000,000 shares authorized; no shares issued and outstanding	—	—
Common stock \$.005 par value; 900,000,000 shares authorized; 462,637,000 and 457,479,000 shares issued and outstanding	2,313	2,287
Additional paid-in capital	1,466,366	1,280,942
Other accumulated comprehensive income/(loss)	16,144	(77,980)
Retained earnings	6,139,987	5,349,731
Total stockholders' equity	<u>7,624,810</u>	<u>6,554,980</u>
	<u>\$15,092,548</u>	<u>\$13,191,688</u>

The accompanying notes are an integral part of these consolidated financial statements.

COSTCO WHOLESALE CORPORATION
CONSOLIDATED STATEMENTS OF INCOME
(dollars in thousands, except per share data)

	52 Weeks Ended August 29, 2004	52 Weeks Ended August 31, 2003	52 Weeks Ended September 1, 2002
REVENUE			
Net sales	\$47,145,712	\$41,692,699	\$37,993,093
Membership fees	961,280	852,853	769,406
Total revenue	48,106,992	42,545,552	38,762,499
OPERATING EXPENSES			
Merchandise costs	42,092,016	37,235,383	33,983,121
Selling, general and administrative	4,597,877	4,097,398	3,575,536
Preopening expenses	30,451	36,643	51,257
Provision for impaired assets and closing costs, net	1,000	19,500	21,050
Operating income	1,385,648	1,156,628	1,131,535
OTHER INCOME (EXPENSE)			
Interest expense	(36,651)	(36,920)	(29,096)
Interest income and other	51,627	38,525	35,745
INCOME BEFORE INCOME TAXES	1,400,624	1,158,233	1,138,184
Provision for income taxes	518,231	437,233	438,201
NET INCOME	<u>\$ 882,393</u>	<u>\$ 721,000</u>	<u>\$ 699,983</u>
NET INCOME PER COMMON SHARE:			
Basic	<u>\$ 1.92</u>	<u>\$ 1.58</u>	<u>\$ 1.54</u>
Diluted	<u>\$ 1.85</u>	<u>\$ 1.53</u>	<u>\$ 1.48</u>
Shares used in calculation (000's)			
Basic	459,223	456,335	453,650
Diluted	482,459	479,326	479,262
Dividends per share	\$ 0.20	\$ —	\$ —

The accompanying notes are an integral part of these consolidated financial statements.

COSTCO WHOLESALE CORPORATION
CONSOLIDATED STATEMENTS OF STOCKHOLDERS' EQUITY
AND COMPREHENSIVE INCOME

For the 52 weeks ended August 29, 2004, the 52 weeks ended August 31, 2003
and the 52 weeks ended September 1, 2002
(in thousands)

	Common Stock		Additional	Other	Retained	Total
	Shares	Amount	Paid-In Capital	Accumulated Comprehensive Income/(Loss)	Earnings	
BALANCE AT SEPTEMBER 2, 2001	451,754	\$2,259	\$1,125,543	\$(173,610)	\$3,928,748	\$4,882,940
Comprehensive Income						
Net Income	—	—	—	—	699,983	699,983
Other accumulated comprehensive income						
Foreign currency translation						
adjustment	—	—	—	15,885	—	15,885
Total comprehensive income	—	—	—	15,885	699,983	715,868
Stock options exercised including income tax						
benefits and other	3,571	18	95,402	—	—	95,420
Conversion of convertible debentures	—	—	9	—	—	9
BALANCE AT SEPTEMBER 1, 2002	455,325	2,277	1,220,954	(157,725)	4,628,731	5,694,237
Comprehensive Income						
Net Income	—	—	—	—	721,000	721,000
Other accumulated comprehensive income						
Foreign currency translation						
adjustment	—	—	—	79,745	—	79,745
Total comprehensive income	—	—	—	79,745	721,000	800,745
Stock options exercised including income tax						
benefits and other	2,154	10	47,919	—	—	47,929
Stock-based compensation	—	—	12,069	—	—	12,069
BALANCE AT AUGUST 31, 2003	457,479	2,287	1,280,942	(77,980)	5,349,731	6,554,980
Comprehensive Income						
Net Income	—	—	—	—	882,393	882,393
Other accumulated comprehensive income						
Foreign currency translation and						
other	—	—	—	94,124	—	94,124
Total comprehensive income	—	—	—	94,124	882,393	976,517
Stock options exercised including income tax						
benefits and other	5,153	26	148,785	—	—	148,811
Conversion of convertible debentures	5	—	131	—	—	131
Stock-based compensation	—	—	36,508	—	—	36,508
Cash dividends	—	—	—	—	(92,137)	(92,137)
BALANCE AT AUGUST 29, 2004	462,637	\$2,313	\$1,466,366	\$ 16,144	\$6,139,987	\$7,624,810

The accompanying notes are an integral part of these consolidated financial statements.

COSTCO WHOLESALE CORPORATION
CONSOLIDATED STATEMENTS OF CASH FLOWS
(dollars in thousands)

	52 Weeks Ended August 29, 2004	52 Weeks Ended August 31, 2003	52 Weeks Ended September 1, 2002
CASH FLOWS FROM OPERATING ACTIVITIES			
Net income	\$ 882,393	\$ 721,000	\$ 699,983
Adjustments to reconcile net income to net cash provided by operating activities:			
Depreciation and amortization	440,721	391,302	341,781
Accretion of discount on zero coupon notes	18,421	17,852	17,233
Stock-based compensation	36,508	12,069	—
Undistributed equity earnings in affiliates	(23,517)	(21,612)	(21,485)
Net (gain)/loss on sale of property and equipment and other	(9,122)	4,907	4,001
Provision for impaired assets	2,592	4,697	—
Change in deferred income taxes	32,496	68,693	12,179
Tax benefit from exercise of stock options	22,712	12,348	27,171
Change in receivables, other current assets, deferred income, accrued and other current liabilities	740,027	232,167	129,883
Increase in merchandise inventories	(256,438)	(162,759)	(380,158)
Increase in accounts payable	211,990	226,544	187,655
Total adjustments	1,216,390	786,208	318,260
Net cash provided by operating activities	2,098,783	1,507,208	1,018,243
CASH FLOWS FROM INVESTING ACTIVITIES			
Additions to property and equipment	(705,620)	(810,665)	(1,038,605)
Proceeds from the sale of property and equipment	55,400	51,829	32,849
Purchase of minority interest	(95,153)	—	—
Investment in unconsolidated joint ventures	—	—	(1,000)
(Increase)/decrease in short-term investments	(303,945)	—	4,928
Decrease/(increase) in other assets and other, net	837	(31,752)	(31,987)
Net cash used in investing activities	(1,048,481)	(790,588)	(1,033,815)
CASH FLOWS FROM FINANCING ACTIVITIES			
Repayments of short-term borrowings, net	(31,492)	(58,144)	(99,175)
Net proceeds from issuance of long-term debt	—	59,424	300,000
Repayments of long-term debt	(6,602)	(11,823)	(18,540)
Change in bank checks outstanding	212,251	(31,639)	(35,136)
Cash dividend payments	(92,137)	—	—
Proceeds from minority interests	2,805	6,087	3,908
Exercise of stock options	124,744	34,667	66,771
Net cash provided by/(used in) financing activities	209,569	(1,428)	217,828
EFFECT OF EXCHANGE RATE CHANGES ON CASH	17,825	24,729	677
Increase in cash and cash equivalents	1,277,696	739,921	202,933
CASH AND CASH EQUIVALENTS BEGINNING OF YEAR	1,545,439	805,518	602,585
CASH AND CASH EQUIVALENTS END OF YEAR	<u>\$ 2,823,135</u>	<u>\$1,545,439</u>	<u>\$ 805,518</u>
SUPPLEMENTAL DISCLOSURE OF CASH FLOW INFORMATION:			
Cash paid during the year for:			
Interest (excludes amounts capitalized)	\$ 14,648	\$ 20,861	\$ 9,511
Income taxes	\$ 327,368	\$ 320,546	\$ 351,003

The accompanying notes are an integral part of these consolidated financial statements.

COSTCO WHOLESALE CORPORATION
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
(dollars in thousands, except per share data)

Note 1—Summary of Significant Accounting Policies

Basis of Presentation

The consolidated financial statements include the accounts of Costco Wholesale Corporation, a Washington corporation, and its subsidiaries ("Costco" or the "Company"). All material inter-company transactions between the Company and its subsidiaries have been eliminated in consolidation.

Costco operates membership warehouses that offer low prices on a limited selection of nationally branded and selected private label products in a wide range of merchandise categories in no-frills, self-service warehouse facilities. At August 29, 2004, Costco operated 441 warehouse clubs: 324 in the United States and three in Puerto Rico; 63 in Canada; 15 in the United Kingdom; five in Korea; three in Taiwan; four in Japan; and 24 warehouses in Mexico with a joint venture partner.

The Company's investments in the Costco Mexico joint venture and in other unconsolidated joint ventures that are less than majority owned are accounted for under the equity method. The investment in Costco Mexico is included in other assets and was \$178,997 at August 29, 2004 and \$167,293 at August 31, 2003. The equity in earnings of Costco Mexico is included in interest income and other and for fiscal 2004, 2003 and 2002, was \$22,208, \$21,400 and \$21,028, respectively. The amount of retained earnings that represents undistributed earnings of Costco Mexico was \$108,282 and \$86,074 at August 29, 2004 and August 31, 2003, respectively.

Fiscal Years

The Company reports on a 52/53-week fiscal year basis, which ends on the Sunday nearest August 31st. Fiscal years 2004, 2003 and 2002 were 52-week years.

Cash Equivalents

The Company considers all highly liquid investments with a maturity of three months or less at the date of purchase and proceeds due from credit and debit card transactions with settlement terms of less than five days to be cash equivalents. Of the total cash and cash equivalents of \$2,823,135 at August 29, 2004 and \$1,545,439 at August 31, 2003, credit and debit card receivables were \$441,244 and \$412,861, respectively.

Short-term Investments

Short-term investments have a maturity of three months to five years at the date of purchase. Investments with maturities beyond one year may be classified as short-term based on their highly liquid nature and because such marketable securities represent the investment of cash that is available for current operations. Short-term investments classified as available for sale are recorded at market value using the specific identification method; unrealized gains and losses are reflected in other accumulated comprehensive income or loss. Included within corporate notes and bonds are investments totaling \$171,179 that have been designated as "hold to maturity securities" and are recorded at cost. At August 29, 2004, the cost of these securities approximated market value.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
(dollars in thousands, except per share data) (Continued)

Note 1—Summary of Significant Accounting Policies (Continued)

Short-term investments at August 29, 2004 were as follows:

	Cost Basis	Unrealized Gains	Unrealized Losses	Recorded Basis
U.S. government and agency securities	\$ 46,060	\$102	\$(107)	\$ 46,055
Money market mutual funds	25,112	—	—	25,112
Corporate notes and bonds	216,271	95	(149)	216,217
Asset backed securities	13,283	16	(115)	13,184
Mortgage backed securities	6,161	18	—	6,179
Total short-term investments	<u>\$306,887</u>	<u>\$231</u>	<u>\$(371)</u>	<u>\$306,747</u>

Receivables, net

Receivables consist primarily of vendor rebates and promotional allowances, receivables from government tax authorities and other miscellaneous amounts due to the Company, and are net of an allowance for doubtful accounts of \$1,139 at August 29, 2004 and \$1,529 at August 31, 2003. Management determines the allowance for doubtful accounts based on known troubled accounts and historical experience applied to an aging of accounts.

Vendor Rebates and Allowances

Periodic payments from vendors in the form of volume rebates or other purchase discounts that are evidenced by signed agreements are reflected in the carrying value of the inventory when earned or as the Company progresses towards earning the rebate or discount and as a component of cost of sales as the merchandise is sold. Other consideration received from vendors is generally recorded as a reduction of merchandise costs upon completion of contractual milestones, terms of the related agreement, or by other systematic and rational approach.

Merchandise Inventories

Merchandise inventories are valued at the lower of cost or market as determined primarily by the retail inventory method, and are stated using the last-in, first-out (LIFO) method for substantially all U.S. merchandise inventories. Merchandise inventories for all foreign operations are primarily valued by the retail method of accounting, and are stated using the first-in, first-out (FIFO) method. The Company believes the LIFO method more fairly presents the results of operations by more closely matching current costs with current revenues. The Company records an adjustment each quarter if necessary, for the expected annual effect of inflation and these estimates are adjusted to actual results determined at year-end. The Company considers in its calculation of the LIFO cost the estimated net realizable value of inventory in those inventory pools where deflation exists and records a write down of inventory where estimated net realizable value is less than LIFO inventory. The LIFO inventory adjustment for the fourth quarter of fiscal 2004 decreased gross margin by \$590 as compared to an increase of \$14,650 in the fourth quarter of fiscal 2003. If all merchandise inventories had been valued using the FIFO method, inventories would have been lower by \$13,410 and \$19,500 at August 29, 2004 at August 31, 2003, respectively.

	August 29, 2004	August 31, 2003
Merchandise inventories consist of:		
United States (primarily LIFO)	\$2,903,551	\$2,668,342
Foreign (FIFO)	<u>740,034</u>	<u>671,086</u>
Total	<u>\$3,643,585</u>	<u>\$3,339,428</u>

Note 1—Summary of Significant Accounting Policies (Continued)

The Company provides for estimated inventory losses between physical inventory counts on the basis of a standard percentage of sales. This provision is adjusted periodically to reflect the actual shrinkage results of the physical inventory counts, which generally occur in the second and fourth quarters of the Company's fiscal year.

Property and Equipment

Property and equipment are stated at cost. Depreciation and amortization expenses are computed using the straight-line method for financial reporting purposes. Buildings are generally depreciated over twenty-five to thirty-five years; equipment and fixtures are depreciated over three to ten years; leasehold improvements are amortized over the initial term of the lease or the useful lives of the assets. The Company capitalizes certain costs related to the acquisition and development of software and amortizes those costs using the straight-line method over their estimated useful lives, which range from three to five years.

Interest costs incurred on property and equipment during the construction period are capitalized. The amount of interest costs capitalized was \$4,155 in fiscal 2004, \$3,272 in fiscal 2003, and \$13,480 in fiscal 2002.

Impairment of Long-Lived Assets

The Company periodically evaluates the realizability of long-lived assets for impairment when management makes the decision to relocate or close a warehouse or when events or changes in circumstances occur, which may indicate the carrying amount of the asset may not be recoverable. The Company evaluates the carrying value of the asset by comparing the estimated future undiscounted cash flows generated from the use of the asset and its eventual disposition with the asset's reported net carrying value. The Company recorded a pre-tax, non-cash charge of \$2,592, \$4,697 and \$0 in fiscal 2004, 2003 and 2002, respectively, reflecting its estimate of impairment relating to real property. The charge reflects the difference between the carrying value and fair value, which was based on estimated market valuations for those assets whose carrying value is not currently anticipated to be recoverable through future cash flows.

Goodwill

Goodwill, net of accumulated amortization, resulting from certain business combinations is included in other assets, and totaled \$65,721 at August 29, 2004 and \$46,549 at August 31, 2003. The increase in goodwill was due to the Company increasing its ownership in Costco Wholesale UK Limited from 80% to 100% in the first quarter of fiscal 2004. The Company follows Statement of Financial Accounting Standards (SFAS) No. 142, "Accounting for Goodwill and Other Intangibles," which specifies that goodwill and some intangible assets should no longer be amortized, but instead will be subject to periodic impairment testing. Accordingly, the Company reviews previously reported goodwill for impairment on an annual basis, or more frequently if circumstances dictate. No impairment of goodwill has been incurred to date.

Accounts Payable

The Company's banking system provides for the daily replenishment of major bank accounts as checks are presented. Accordingly, included in accounts payable at August 29, 2004 and August 31, 2003 are \$438,025 and \$216,980, respectively, representing the excess of outstanding checks over cash on deposit at the banks on which the checks were drawn.

Insurance/Self Insurance Liabilities

The Company uses a combination of insurance and self-insurance mechanisms to provide for the potential liabilities for workers' compensation, general liability, property insurance, director and officers' liability, vehicle liability and employee health care benefits. Liabilities associated with the risks that are retained by the Company are not discounted and are estimated, in part, by considering historical claims experience and outside expertise,

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
(dollars in thousands, except per share data) (Continued)

Note 1—Summary of Significant Accounting Policies (Continued)

demographic factors, severity factors and other actuarial assumptions. The estimated accruals for these liabilities could be significantly affected if future occurrences and claims differ from these assumptions and historical trends.

Derivatives

The Company has limited involvement with derivative financial instruments and uses them only to manage well-defined interest rate and foreign exchange risks. Short-term forward foreign exchange contracts are used to hedge the impact of fluctuations of foreign exchange on inventory purchases. The only significant derivative instruments the Company holds are interest rate swaps, which the Company uses to manage the interest rate risk associated with its borrowings and to manage the Company's mix of fixed and variable-rate debt. As of August 29, 2004, the Company had "fixed-to-floating" interest rate swaps with an aggregate notional amount of \$600,000 and an aggregate fair value of \$25,754, which is recorded in other assets. These swaps were entered into effective November 13, 2001, and March 25, 2002, and are designated and qualify as fair value hedges of the Company's \$300,000 7 1/8% Senior Notes and the Company's \$300,000 5 1/2% Senior Notes, respectively. As the terms of the swaps match those of the underlying hedged debt, the changes in the fair value of these swaps are offset by corresponding changes in the fair value recorded on the hedged debt, and result in no net earnings impact.

Equity Investments in Subsidiary

On October 3, 2003, the Company acquired from Carrefour Nederland B.V. its 20% equity interest in Costco Wholesale UK Limited for cash of \$95,153, bringing Costco's ownership in Costco Wholesale UK Limited to 100%. In conjunction with this purchase the Company increased the carrying value of the land and buildings of Costco Wholesale UK Limited by \$12,808 and recorded goodwill of \$16,719.

Foreign Currency Translations

The functional currencies of the Company's international subsidiaries are the local currency of the country in which the subsidiary is located. Assets and liabilities recorded in foreign currencies, as well as the Company's investment in the Costco Mexico joint venture, are translated at the exchange rate on the balance sheet date. Translation adjustments resulting from this process are charged or credited to other accumulated comprehensive income (loss). Revenue and expenses of the Company's consolidated foreign operations are translated at average rates of exchange prevailing during the year. Gains and losses on foreign currency transactions are included in expenses and were not significant in either fiscal 2004, 2003, or 2002.

Revenue Recognition

The Company recognizes sales, net of estimated returns, at the time the customer takes possession of merchandise or receives services. When the Company collects payment from customers prior to the transfer of ownership of merchandise or the performance of services, the amount received is recorded as deferred revenue on the consolidated balance sheets until the sale or service is completed. The Company provides for estimated sales returns based on historical returns levels. The reserve for sales returns (sales returns net of merchandise costs) was \$5,524 and \$4,869 at August 29, 2004 and August 31, 2003, respectively.

Membership fee revenue represents annual membership fees paid by substantially all of the Company's members. The Company accounts for membership fee revenue on a "deferred basis," whereby membership fee revenue is recognized ratably over the one-year term of the membership. The Company's Executive members

Note 1—Summary of Significant Accounting Policies (Continued)

qualify for a 2% reward (which can be redeemed at Costco warehouses), up to a maximum of \$500 per year, on all qualified purchases made at Costco. The Company accounts for this 2% reward as a reduction in sales, with the related liability being classified within other current liabilities. The sales reduction and corresponding liability are computed after giving effect to the estimated impact of non-redemptions based on historical data. The reduction in sales for the fiscal years ended August 29, 2004, August 31, 2003 and September 1, 2002, and the related liability as of those dates were as follows:

	Fiscal Year Ended		
	August 29, 2004	August 31, 2003	September 1, 2002
Two-percent reward sales reduction	\$244,487	\$169,612	\$143,637
Two-percent unredeemed reward liability	\$170,941	\$114,681	\$ 94,448

Merchandise Costs

Merchandise costs consist of the purchase price of inventory sold, inbound shipping charges and all costs related to our depot operations, including freight from depots to selling warehouses. Merchandise costs also include salaries, benefits, depreciation on production equipment, and other related expenses incurred in certain fresh foods and ancillary departments.

Selling, General and Administrative Expenses

Selling, general and administrative expenses consist primarily of salaries, benefits and workers' compensation costs for warehouse employees, other than fresh foods and certain ancillary businesses, as well as all regional and home office employees, including buying personnel. Selling, general and administrative expenses also include utilities, bank charges and substantially all building and equipment depreciation, as well as other operating costs incurred to support warehouse operations.

Marketing and Promotional Expenses

Costco's policy is generally to limit marketing and promotional expenses to new warehouse openings, occasional direct mail marketing to prospective new members and direct mail marketing programs to existing members promoting selected merchandise. Marketing and promotional costs are expensed as incurred.

Preopening Expenses

Preopening expenses related to new warehouses, major remodels/expansions, new regional offices and other startup operations are expensed as incurred.

Stock-Based Compensation

The Company adopted the fair value based method of recording stock options consistent with SFAS No. 123, "Accounting for Stock-Based Compensation," for all employee stock options granted subsequent to fiscal year end 2002. Specifically, the Company adopted SFAS No. 123 using the "prospective method" with guidance provided from SFAS No. 148, "Accounting for Stock-Based Compensation – Transition and Disclosure." All employee stock option grants made since the beginning of fiscal 2003 have or will be expensed over the related stock option vesting period based on the fair value at the date the options are granted. Prior to fiscal 2003, the Company applied Accounting Principles Board Opinion (APB) No. 25, "Accounting for Stock Issued to Employees," and related interpretations in accounting for stock options. Because the Company granted stock options to employees at exercise prices equal to fair market value on the date of grant, no compensation cost was recognized for option grants.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
(dollars in thousands, except per share data) (Continued)

Note 1—Summary of Significant Accounting Policies (Continued)

Had compensation costs for the Company's stock-based compensation plans been determined based on the fair value at the grant dates for awards made prior to fiscal 2003, under those plans and consistent with SFAS No. 123, the Company's net income and net income per share would have been reduced to the pro forma amounts indicated below:

	Fiscal Year Ended		
	August 29, 2004	August 31, 2003	September 1, 2002
Net income, as reported	\$882,393	\$721,000	\$699,983
Add: Stock-based employee compensation expense included in reported net income, net of related tax effects	23,000	7,513	—
Deduct: Total stock-based employee compensation expense determined under fair value based methods for all awards, net of related tax effects	(58,388)	(70,257)	(75,743)
Pro-forma net income	<u>\$847,005</u>	<u>\$658,256</u>	<u>\$624,240</u>
Net Income per share:			
Basic—as reported	\$ 1.92	\$ 1.58	\$ 1.54
Basic—pro-forma	\$ 1.84	\$ 1.44	\$ 1.38
Diluted—as reported	\$ 1.85	\$ 1.53	\$ 1.48
Diluted—pro-forma	<u>\$ 1.78</u>	<u>\$ 1.40</u>	<u>\$ 1.32</u>

Fair Value of Financial Instruments

The carrying value of the Company's financial instruments, including cash and cash equivalents, receivables and accounts payable approximate fair value due to their short-term nature or variable interest rates. Short-term investments classified as available for sale are recorded at market value with unrealized gains or losses reflected in other accumulated comprehensive income or loss. Short-term investments designated as "hold-to-maturity" securities are recorded at cost and approximated market value at August 29, 2004. The fair value of fixed rate debt at August 29, 2004 and August 31, 2003 was \$1,581,368 and \$1,415,252, respectively.

Closing Costs

Warehouse closing costs incurred relate principally to the Company's efforts to relocate certain warehouses that were not otherwise impaired to larger and better-located facilities. The provision for fiscal 2004 included charges of \$16,548 for warehouse closing expenses offset by net gains of \$15,548 related to the sale of real property. The fiscal 2003 provision included charges of \$11,836 for warehouse closing expenses and \$2,967 for net losses on the sale of real property. As of August 29, 2004, the Company's reserve for warehouse closing costs was \$10,367, of which \$9,184 related to future lease obligations. This compares to a reserve for warehouse closing costs of \$8,609 at August 31, 2003, of which \$7,833 related to future lease obligations.

Note 1—Summary of Significant Accounting Policies (Continued)

Interest Income and Other

Interest income and other includes:

	Fiscal Year Ended		
	August 29, 2004	August 31, 2003	September 1, 2002
Interest income	\$31,537	\$21,200	\$16,005
Minority interest/earnings of affiliates and other	20,090	17,325	19,740
Total	<u>\$51,627</u>	<u>\$38,525</u>	<u>\$35,745</u>

The Company recently determined that its joint venture Costco Mexico had incorrectly reported to the Company the amount of deferred taxes recorded by Costco Mexico under SFAS No. 109, "Accounting for Income Taxes." As a result, the Company overstated its share in the equity in earnings of Costco Mexico (reported in interest income and other) in fiscal years 2004, 2003 and 2002 by approximately \$1,000, \$1,000 and \$6,000, respectively - representing less than 1% of the Company's income before income taxes in each of these years. The cumulative balance sheet effect (reflected in other assets), over the past 12 fiscal years, has been to overstate the Company's investment in Costco Mexico by approximately \$24,000, or less than .16% of total assets at fiscal 2004 year end. The Company believes that the incorrect reporting of deferred taxes of Costco Mexico has not materially impacted its consolidated results of operations, financial position or cash flows. Accordingly, these amounts have not been adjusted in the accompanying consolidated financial statements.

Income Taxes

The Company accounts for income taxes under the provisions of SFAS No. 109, "Accounting for Income Taxes." That standard requires companies to account for deferred income taxes using the asset and liability method.

Under the asset and liability method of SFAS No. 109, deferred tax assets and liabilities are recognized for the future tax consequences attributed to differences between the financial statement carrying amounts of existing assets and liabilities and their respective tax bases and tax credits and loss carry-forwards. Deferred tax assets and liabilities are measured using enacted tax rates expected to apply to taxable income in the years in which those temporary differences and carry-forwards are expected to be recovered or settled. The effect on deferred tax assets and liabilities of a change in tax rates is recognized in income in the period that includes the enactment date. A valuation allowance is established when necessary to reduce deferred tax assets to amounts expected to be realized.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
(dollars in thousands, except per share data) (Continued)

Note 1—Summary of Significant Accounting Policies (Continued)

Net Income Per Common and Common Equivalent Share

The following data show the amounts used in computing earnings per share (EPS) and the effect on income and the weighted average number of shares of dilutive potential common stock.

	52 Weeks Ended August 29, 2004	52 Weeks Ended August 31, 2003	52 Weeks Ended September 1, 2002
Net income available to common stockholders used in basic			
EPS	\$882,393	\$721,000	\$699,983
Interest on convertible bonds, net of tax	11,607	11,109	10,602
Net income available to common stockholders after assumed conversions of dilutive securities	<u>\$894,000</u>	<u>\$732,109</u>	<u>\$710,585</u>
Weighted average number of common shares used in basic			
EPS (000's)	459,223	456,335	453,650
Stock options (000's)	3,892	3,646	6,267
Conversion of convertible bonds (000's)	<u>19,344</u>	<u>19,345</u>	<u>19,345</u>
Weighted number of common shares and dilutive potential common stock used in diluted EPS (000's)	<u>482,459</u>	<u>479,326</u>	<u>479,262</u>

The diluted share base calculation for fiscal years ended August 29, 2004, August 31, 2003 and September 1, 2002, excludes 24,747,815, 33,362,000 and 6,908,000 stock options outstanding, respectively. These options are excluded due to their anti-dilutive effect.

Dividends

Costco's Board of Directors declared two quarterly cash dividends of \$0.10 per share in fiscal 2004. The first quarterly cash dividend of \$0.10 per share, in the amount of \$45,939, was paid May 31, 2004 to shareholders of record at the close of business on May 10, 2004. The second quarterly cash dividend of \$0.10 per share, in the amount of \$46,198, was paid August 27, 2004, to shareholders of record at the close of business on July 23, 2004. The Company presently expects to pay a cash dividend on a quarterly basis going forward.

Stock Repurchase Program

On November 30, 2001, the Company's Board of Directors approved a stock repurchase program authorizing the repurchase of up to \$500,000 of Costco Common Stock through November 30, 2004. Under the program, the Company could repurchase shares at any time in the open market or in private transactions as market conditions warrant. The repurchased shares would constitute authorized, but non-issued shares and would be used for general corporate purposes, including stock option grants under stock option programs. On October 25, 2004, the Board of Directors renewed the program for another three years. To date, no shares have been repurchased under either program.

Recent Accounting Pronouncements

In March 2004, the Financial Accounting Standards Board's (FASB) Emerging Issues Task Force (EITF) reached a consensus on EITF Issue No. 03-1, "The Meaning of Other-Than-Temporary Impairment and Its Application to Certain Investments," (EITF 03-1). The guidance prescribes a three-step model for determining whether an investment is other-than-temporarily impaired and requires disclosures about unrealized losses on investments. The accounting guidance is effective for reporting periods beginning after June 15, 2004, while the

Note 1—Summary of Significant Accounting Policies (Continued)

disclosure requirements are effective for annual reporting periods ending after June 15, 2004. In September 2004, the FASB issued FASB Staff Position EITF 03-1-1, "Effective Date of Paragraphs 10-20 of EITF Issue No. 03-1 'The Meaning of Other-Than-Temporary Impairment and Its Application to Certain Investments,'" (FSP EITF 03-01-1). FSP EITF 03-1-1 delays the effective date for the measurement and recognition guidance contained in paragraphs 10-20 of EITF Issue 03-01. During the period of the delay, FSP EITF 03-1-1 states that companies should continue to apply relevant "other-than-temporary" guidance. The adoption of EITF 03-1, excluding paragraphs 10-20, did not impact the Company's consolidated financial statements. The Company will assess the impact of paragraphs 10-20 of EITF 03-1 once the guidance has been finalized.

In December 2003, the FASB issued Interpretation No. 46 (revised December 2003), "Consolidation of Variable Interest Entities" (FIN 46R), which addresses how a business enterprise should evaluate whether it has a controlling financial interest in an entity through means other than voting rights and accordingly should consolidate the entity. In general, a variable interest entity is a corporation, partnership, trust, or any other legal structure used for business purposes that either does not have equity investors with voting rights or has equity investors that do not provide sufficient financial resources for the entity to support its activities. FIN 46R requires a variable interest entity to be consolidated by a company if that company is subject to a majority of the risk of loss from the variable interest entity's activities or entitled to receive a majority of the entity's residual returns or both. FIN 46R replaces FASB Interpretation No. 46, "Consolidation of Variable Interest Entities," which was issued in January 2003 and revised the implementation date to the first fiscal period ending after March 15, 2004, with the exception of special purpose entities. The adoption of this interpretation did not have a material impact on the Company's consolidated financial statements.

In November 2003, the EITF reached consensus on Issue No. 03-10, "Application of Issue No. 02-16 by Resellers to Sales Incentives Offered to Consumers by Manufacturers," with respect to determining if consideration received by a reseller from a vendor that is reimbursed by the vendor for honoring the vendor's sale incentives offered directly to consumers should be recorded as a reduction in sales. These rules apply to transactions entered into by consumers in fiscal periods beginning after November 25, 2003 and, therefore, apply to such transactions starting with the Company's fiscal third quarter of 2004, which began February 16, 2004. The adoption of EITF 03-10 did not affect the Company's consolidated gross profit or net income, but did result in a reduction of both net sales and merchandise costs by an equal amount. For fiscal 2004, net sales and merchandise costs have been reduced by \$334,065. Had the Company's comparable periods in fiscal 2003 and 2002 been reported under EITF 03-10 guidance, the sales and cost of sales would have been reduced by \$282,288 and \$248,155, respectively.

In November 2002, the EITF reached consensus on certain issues discussed in Issue No. 02-16, "Accounting by a Customer (Including a Reseller) for Certain Consideration Received from a Vendor," with respect to determining how a reseller should characterize consideration received from a vendor and when to recognize and how to measure that consideration in its income statement. Requirements for recognizing volume-based rebates are effective for arrangements entered into or modified after November 21, 2002 and resellers with other supplier payments should generally apply the new rules prospectively for agreements entered into or modified after December 31, 2002. The adoption of this consensus by the Company in fiscal 2003 did not have a significant impact on the Company on an annual basis. However, the application of the consensus has resulted in a change in the timing for the recognition of some vendor allowances for certain agreements entered into subsequent to December 31, 2002 and extends the recognition time frame beyond that which was in effect for similar contracts entered into prior to December 31, 2002. Net income for fiscal 2004 was negatively impacted by approximately \$2,808 (after-tax) due to the adoption of EITF 02-16.

Use of Estimates

The preparation of financial statements in conformity with accounting principles generally accepted in the United States requires management to make estimates and assumptions that affect the reported amounts of assets

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
(dollars in thousands, except per share data) (Continued)

Note 1—Summary of Significant Accounting Policies (Continued)

and liabilities and the disclosure of contingent assets and liabilities at the date of the financial statements and the reported amounts of revenues and expenses during the reporting period. Actual results could differ from those estimates.

Reclassifications

Certain reclassifications have been made to prior fiscal years to conform with the presentation adopted in the current fiscal year.

Note 2—Comprehensive Income

Comprehensive income is net income, plus certain other items that are recorded directly to stockholders' equity. Comprehensive income was \$976,517 for fiscal 2004 and \$800,745 for fiscal 2003. Foreign currency translation adjustments and unrealized gains and losses on short-term investments are the components applied to net income to calculate the Company's comprehensive income and totaled \$94,264 and (\$140), respectively, for fiscal 2004 and \$79,745, which related only to foreign currency translation adjustments in fiscal 2003.

Note 3—Debt

Bank Credit Facilities and Commercial Paper Programs (all amounts stated in thousands of US dollars)

The Company has in place a \$500,000 commercial paper program supported by a \$300,000 bank credit facility with a group of ten banks, of which \$150,000 expired on November 9, 2004 and \$150,000 expires on November 15, 2005. At August 29, 2004 and August 31, 2003, no amounts were outstanding under the commercial paper program and no amounts were outstanding under the credit facility. The Company presently does not plan to renew the \$150,000 portion of the credit facility that expired on November 9, 2004.

A wholly-owned Canadian subsidiary has a \$152,000 commercial paper program supported by a \$46,000 bank credit facility with a Canadian bank that is guaranteed by the parent company and expires in March 2005. At August 29, 2004 and August 31, 2003, no amounts were outstanding under the Canadian commercial paper program or the bank credit facility.

The Company has agreed to limit the combined amount outstanding under the U.S. and Canadian commercial paper programs to the combined amounts of the supporting bank credit facilities, which are \$346,000 at August 29, 2004, decreased to \$196,000 on November 9, 2004.

The Company's wholly-owned Japanese subsidiary has a short-term \$27,400 bank line of credit that originally expired in November 2004. Subsequent to the Company's fiscal year end, the bank line of credit was extended through February 10, 2005. At August 29, 2004 and August 31, 2003, no amounts were outstanding under the line of credit.

The Company's Korean subsidiary has a short-term \$10,400 bank line of credit, which expires in January 2005. At August 29, 2004, no amounts were outstanding under the line of credit.

The Company's wholly-owned United Kingdom subsidiary has a \$108,000 bank revolving credit facility expiring in February 2007 and a \$63,000 bank overdraft facility renewable on a quarterly basis in March. At August 29, 2004, \$21,595 was outstanding under the revolving credit facility with an applicable interest rate of 5.285% and no amounts were outstanding under the bank overdraft facility. At August 31, 2003, \$47,421 was outstanding under the revolving credit facility with an applicable interest rate of 4.413% and no amounts were outstanding under the bank overdraft facility.

Note 3—Debt (Continued)

Letters of Credit

The Company has letter of credit facilities (for commercial and standby letters of credit), totaling approximately \$338,000. The outstanding commitments under these facilities at August 29, 2004 totaled approximately \$166,800, including approximately \$52,900 in standby letters of credit.

Short-Term Borrowings

The weighted average borrowings, maximum borrowings and weighted average interest rate under all short-term borrowing arrangements were as follows for fiscal 2004 and 2003:

Category of Aggregate Short-term Borrowings	Maximum Amount Outstanding During the Fiscal Year	Average Amount Outstanding During the Fiscal Year	Weighted Average Interest Rate During the Fiscal Year
Fiscal year ended August 29, 2004			
Bank borrowings:			
Canadian	\$ 53,826	\$ 3,005	2.73%
Other International	48,232	21,994	4.40
Fiscal year ended August 31, 2003			
Bank borrowings:			
Canadian	\$ 5,655	\$ 367	4.65%
Other International	127,098	81,431	3.68
U.S. Commercial Paper	17,657	2,065	4.92

Long-term Debt

Long-term debt at August 29, 2004 and August 31, 2003 consisted of the following:

	2004	2003
7 1/8% Senior Notes due June 2005	\$ 304,350	\$ 308,684
5 1/2% Senior Notes due March 2007	321,404	325,520
2.070% Promissory notes due October 2007	32,004	30,079
1.187% Promissory notes due July 2008	27,432	25,782
0.88% Promissory notes due November 2009	27,432	25,782
0.92% Promissory notes due April 2010	36,576	34,376
3 1/2% Zero Coupon convertible subordinated notes due August 2017	543,025	524,735
Notes payable secured by trust deeds on real estate	—	8,023
Capital lease obligations and other	7,117	13,719
	1,299,340	1,296,700
Less current portion	305,594	7,051
Total long-term debt	<u>\$ 993,746</u>	<u>\$1,289,649</u>

In June 1995, the Company issued \$300,000 of 7 1/8% Senior Notes due June 15, 2005. Interest on the notes is payable semiannually on June 15 and December 15. The indentures contain certain limitations on the Company's and certain subsidiaries' ability to create liens securing indebtedness and to enter into certain sale-leaseback transactions. In November 2001, the Company entered into "fixed-to-floating" interest rate swap agreements that replaced the fixed interest rate with a floating rate indexed to LIBOR. The Company plans to repay the 7 1/8% Senior Notes from its cash and cash equivalents and short-term investments balances, which total \$3,129,882 at August 29, 2004.

In March 2002, the Company issued \$300,000 of 5 1/2% Senior Notes due March 15, 2007. Interest is payable semi-annually on March 15 and September 15. Simultaneous with the issuance of the 5 1/2% Senior Notes,

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
(dollars in thousands, except per share data) (Continued)

Note 3—Debt (Continued)

the Company entered into interest rate swap agreements converting the interest to a floating rate indexed to LI-BOR. As of August 29, 2004, the Company was in compliance with all restrictive covenants.

In October 2000, the Company's wholly-owned Japanese subsidiary issued 2.070% promissory notes in the aggregate amount of approximately \$32,004, through a private placement. Interest is payable annually and principal is due on October 23, 2007.

In July 2001, the Company's wholly-owned Japanese subsidiary issued 1.187% promissory notes in the aggregate amount of approximately \$27,432, through a private placement. Interest is payable semi-annually and principal is due on July 9, 2008.

In November 2002, the Company's wholly-owned Japanese subsidiary issued promissory notes bearing interest at 0.88% in the aggregate amount of approximately \$27,432, through a private placement. Interest is payable semi-annually and principal is due on November 7, 2009.

In April 2003, the Company's wholly-owned Japanese subsidiary issued promissory notes bearing interest at 0.92% in the aggregate amount of approximately \$36,576, through a private placement. Interest is payable semi-annually and principal is due on April 26, 2010.

The Company guarantees all of the promissory notes issued by its wholly-owned Japanese subsidiary.

On August 19, 1997, the Company completed the sale of \$900,000 principal amount at maturity Zero Coupon Subordinated Notes (the "Notes") due August 19, 2017. The Notes were priced with a yield to maturity of 3 1/2%, resulting in gross proceeds to the Company of \$449,640. The current Notes outstanding are convertible into a maximum of 19,340,158 shares of Costco Common Stock shares at an initial conversion price of \$22.00. Holders of the Notes may require the Company to purchase the Notes (at the discounted issue price plus accrued interest to date of purchase) on August 19, 2007, or 2012. The Company, at its option, may redeem the Notes (at the discounted issue price plus accrued interest to date of redemption) any time on or after August 19, 2002. As of August 29, 2004, \$48,352 in principal amount of the Zero Coupon Notes had been converted by note holders to shares of Costco Common Stock.

In February 1996, the Company filed with the Securities and Exchange Commission a shelf registration statement for \$500,000 of senior debt securities. On October 23, 2001, an additional \$100,000 in debt securities was registered, bringing the total amount of debt registered under the shelf registration to \$600,000. The \$300,000 of 5 1/2% Senior Notes issued in March 2002 reduced the amount of registered securities available for future issuance to \$300,000.

At August 29, 2004, the fair value of the 7 1/8% Senior Notes, and the 5 1/2% Senior Notes, based on market quotes, was approximately \$311,250 and \$316,950, respectively. The Senior Notes are not redeemable prior to maturity. The fair value of the 3 1/2% Zero Coupon Subordinated Notes at August 29, 2004, based on market quotes, was approximately \$822,607. The fair value of other long-term debt approximates carrying value.

Maturities of long-term debt during the next five fiscal years and thereafter are as follows:

2005	\$ 305,594
2006	879
2007	322,305
2008	61,467
2009	450
Thereafter	608,645
Total	<u>\$1,299,340</u>

Note 4—Leases

The Company leases land and/or warehouse buildings at 91 of the 417 warehouses open at August 29, 2004, and certain other office and distribution facilities under operating leases with remaining terms ranging from 1 to 44 years. These leases generally contain one or more of the following options which the Company can exercise at the end of the initial lease term: (a) renewal of the lease for a defined number of years at the then fair market rental rate; (b) purchase of the property at the then fair market value; or (c) right of first refusal in the event of a third party purchase offer. Certain leases provide for periodic rental increases based on the price indices and some of the leases provide for rents based on the greater of minimum guaranteed amounts or sales volume. Contingent rents have not been material. The Company accounts for its leases with step-rent provisions on a straight-line basis over the original term of the lease.

Additionally, the Company leases certain equipment and fixtures under short-term operating leases that permit the Company to either renew for a series of one-year terms or to purchase the equipment at the then fair market value.

Aggregate rental expense for fiscal 2004, 2003, and 2002, was \$95,800, \$84,146, and \$69,894, respectively. Future minimum payments, net of sub-lease income of \$148,339, during the next five fiscal years and thereafter under non-cancelable leases with terms in excess of one year, at August 29, 2004, were as follows:

2005	\$ 110,616
2006	109,305
2007	103,429
2008	98,611
2009	91,790
Thereafter	<u>1,061,027</u>
Total minimum payments	<u>\$1,574,778</u>

Note 5—Stock Options

The Company's 1993 Combined Stock Grant and Stock Option Plan (the "1993 plan") provided for the issuance of up to 60 million shares of its common stock upon the exercise of stock options and up to 3,333,332 shares through stock grants. During fiscal 2002 the 2002 Stock Incentive Plan (the "2002 plan") was adopted following shareholder approval. The 2002 plan authorized 30 million shares of common stock for issuance, subject to adjustment. For future grants, the 2002 plan replaces the 1993 plan and the 1993 plan has been amended to provide that no more options or stock grants may be issued under such plan. Any shares under the 1993 plan that remain available for future option grants (and any additional shares that subsequently become available through cancellation of unexercised options outstanding) will be added to the number of shares available for grant under the 2002 plan. The 2002 plan authorizes the Company to grant stock options to eligible employees, directors and consultants. Options granted under these plans have a ten-year term and generally have a vesting period of five years. At August 29, 2004, options for approximately 27.5 million shares were vested and 11.7 million shares were available for future grants under the plan.

In fiscal 2004, 2003 and 2002 the Company recognized stock compensation costs of \$36,508, \$12,069 and \$0, respectively. The effects of applying SFAS No. 123 were substantially less in fiscal 2003 than the effects on net income and earnings per share in fiscal 2004 and expected in future periods because this was the initial year of adoption. Fiscal 2004 reflects compensation expense from options granted in that year, as well as continuing recognition of expense associated with options issued in prior years as they vest. Shares granted in fiscal 2004 and 2003 totaled 7,780,924 and 8,479,550 shares, respectively, with the majority of these shares being granted in the middle of the fiscal third quarter for both fiscal years.

Total stock compensation costs on a pre-tax basis that would have been recorded had SFAS No. 123 been adopted as of its initial effective date would have totaled \$92,679, \$112,863 and \$123,159 in fiscal 2004, 2003 and 2002, respectively.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
(dollars in thousands, except per share data) (Continued)

Note 5—Stock Options (Continued)

The fair value of each option grant is estimated on the date of grant using the Black-Scholes option-pricing model with the following weighted average assumptions used for grants in 2004, 2003 and 2002:

	2004	2003	2002
Risk free interest rate	3.38%	3.30%	4.45%
Expected life	6 years	6 years	5 years
Expected volatility	44%	46%	46%
Expected dividend yield	1.04%	0%	0%

Stock option transactions relating to the aggregate of the 1993 and 2002 plans are summarized below (shares in thousands):

	2004		2003		2002	
	Shares	Price(1)	Shares	Price(1)	Shares	Price(1)
Outstanding at beginning of fiscal year	48,790	\$31.93	42,961	\$31.49	39,578	\$29.15
Granted(2)	7,781	37.19	8,480	30.47	7,641	38.10
Exercised	(5,153)	24.23	(2,154)	16.13	(3,571)	18.77
Cancelled	(884)	36.27	(497)	37.14	(687)	37.12
Outstanding at end of fiscal year	<u>50,534</u>	<u>\$33.45</u>	<u>48,790</u>	<u>\$31.93</u>	<u>42,961</u>	<u>\$31.49</u>

(1) Weighted-average exercise price/grant price.

(2) The weighted-average fair value based on the Black-Scholes model of options granted during fiscal 2004, 2003 and 2002, were \$16.01, \$14.84 and \$17.83, respectively.

The following table summarizes information regarding stock options outstanding at August 29, 2004 (number of options in thousands):

Range of Prices	Options Outstanding			Options Exercisable	
	Number	Remaining Contractual Life(1)	Price(1)	Number	Price(1)
\$6.66–\$32.87	16,851	5.72	\$24.18	9,723	\$19.45
\$33.54–\$37.35	20,878	7.05	36.10	10,131	35.87
\$37.44–\$52.50	12,805	6.55	41.30	7,659	42.25
	<u>50,534</u>	<u>6.48</u>	<u>\$33.44</u>	<u>27,513</u>	<u>\$31.84</u>

(1) Weighted-average.

At August 31, 2003 and September 1, 2002, there were 25,147 and 19,843 options exercisable at weighted average exercise prices of \$29.02 and \$25.40, respectively.

Note 6—Retirement Plans

The Company has a 401(k) Retirement Plan that is available to all U.S. employees who have completed 90 days of employment. For all U.S. employees, with the exception of California union employees, the plan allows pre-tax deferral against which the Company matches 50% of the first one thousand dollars of employee contributions. In addition, the Company will provide each eligible participant a contribution based on salary and years of service.

Note 6—Retirement Plans (Continued)

California union employees participate in a defined benefit plan sponsored by their union. The Company makes contributions based upon its union agreement. For all the California union employees, the Company sponsored 401(k) plan currently allows pre-tax deferral against which the Company matches 50% of the first five hundred dollars of employee contributions. In addition, the Company will provide each eligible participant a contribution based on hours worked and years of service. The Company has a defined contribution plan for Canadian and United Kingdom employees and contributes a percentage of each employee's salary.

Amounts expensed under these plans were \$169,664, \$149,392 and \$127,189 for fiscal 2004, 2003 and 2002, respectively. The Company has defined contribution 401(k) and retirement plans only, and thus has no liability for post-retirement benefit obligations under the SFAS No. 106 "Employer's Accounting for Post-retirement Benefits Other than Pensions."

Note 7—Income Taxes

The provisions for income taxes for fiscal 2004, 2003 and 2002 are as follows:

	2004	2003	2002
Federal:			
Current	\$ 257,092	\$295,323	\$331,455
Deferred	116,390	35,150	5,263
Total federal	<u>373,482</u>	<u>330,473</u>	<u>336,718</u>
State:			
Current	53,608	58,739	48,256
Deferred	20,479	(470)	4,269
Total state	<u>74,087</u>	<u>58,269</u>	<u>52,525</u>
Foreign:			
Current	171,006	9,634	46,197
Deferred	(100,344)	38,857	2,761
Total foreign	<u>70,662</u>	<u>48,491</u>	<u>48,958</u>
Total provision for income taxes	<u>\$ 518,231</u>	<u>\$437,233</u>	<u>\$438,201</u>

For fiscal 2004 the annual effective tax rate remained constant throughout the year at 37%. In the fourth quarter of fiscal 2003 and 2002 the Company adjusted the annual effective tax rate used in calculating the tax provision from 38.5% to 37.75%, and from 40.0% to 38.5%, respectively, resulting in the reduction in the income tax provision in the fourth quarter of \$5,873 and \$11,315, respectively.

Reconciliation between the statutory tax rate and the effective rate for fiscal 2004, 2003 and 2002 is as follows:

	2004		2003		2002	
Federal taxes at statutory rate	\$490,218	35.00%	\$405,382	35.00%	\$398,364	35.00%
State taxes, net	48,157	3.44	37,875	3.27	34,145	3.00
Foreign taxes, net	(5,729)	(0.41)	(396)	(0.03)	2,732	0.24
Other	(14,415)	(1.03)	(5,628)	(0.49)	2,960	0.26
Provision at effective tax rate	<u>\$518,231</u>	<u>37.00%</u>	<u>\$437,233</u>	<u>37.75%</u>	<u>\$438,201</u>	<u>38.50%</u>

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
(dollars in thousands, except per share data) (Continued)

Note 7—Income Taxes (Continued)

The components of the deferred tax assets and liabilities are as follows:

	August 29, 2004	August 31, 2003
Accrued liabilities and reserves	\$224,523	\$168,683
Deferred membership fees	29,805	141,005
Other	14,991	28,465
Total deferred tax assets	269,319	338,153
Property and equipment	272,310	210,822
Merchandise inventories	74,100	64,701
Other receivables	—	91,126
Total deferred tax liabilities	346,410	366,649
Net deferred tax liabilities	<u>\$(77,091)</u>	<u>\$(28,496)</u>

The deferred tax accounts at August 29, 2004 and August 31, 2003 include current deferred income tax assets of \$116,291 and \$213,939, respectively; non-current deferred income tax assets of \$6,755 and \$14,316, respectively; current deferred income tax liabilities of \$0 and \$74,002, respectively; and non-current deferred income tax liabilities of \$200,137 and \$182,749, respectively.

The Company has not provided for U.S. deferred taxes on cumulative undistributed earnings of non-U.S. affiliates aggregating approximately \$857,963 at August 29, 2004, as such earnings have been reinvested for the foreseeable future. Because of the availability of U.S. foreign tax credits, it is not practicable to determine the U.S. federal income tax liability or benefit associated with such earnings if such earnings were not reinvested for the foreseeable future.

Note 8—Commitments and Contingencies

Legal Proceedings

The Company is involved from time to time in claims, proceedings and litigation arising from its business and property ownership. The Company is a defendant in two actions purportedly brought as class actions on behalf of certain present and former Costco managers in California, in which plaintiffs allege that they have not been properly compensated for overtime work. The Company is also a defendant in an overtime compensation case purportedly brought as a class action on behalf of present and former hourly employees in California, in which plaintiffs allege that Costco's semi-annual bonus formula is improper with regard to retroactive overtime pay. Claims in these three actions are made under various provisions of the California Labor Code and the California Business and Professions Code. Plaintiffs seek restitution/disgorgement, compensatory damages, various statutory penalties, liquidated damages, punitive, treble and exemplary damages, and attorneys' fees. The Company also is a defendant in an action purportedly brought as a class action on behalf of certain present and former female managers, in which plaintiffs allege denial of promotion based on gender in violation of Title VII of the Civil Rights Act of 1964. Plaintiffs seek compensatory damages, exemplary and punitive damages, injunctive relief, and attorneys' fees. In none of these four cases has the Court been asked yet to determine whether the action should proceed as a class action or, if so, the definition of the class. The Company expects to vigorously defend these actions and does not believe that any claim, proceeding or litigation, either alone or in the aggregate, will have a material adverse effect on the Company's financial position or results of its operations.

Note 9—Segment Reporting

The Company and its subsidiaries are principally engaged in the operation of membership warehouses in the United States, Canada, Japan and the United Kingdom and through majority owned subsidiaries in Taiwan and Korea and through a 50%-owned joint venture in Mexico. The Company's reportable segments are based on management responsibility and exclude the Mexico joint-venture, as it is accounted for under the equity method and its operations are not consolidated in the Company's financial statements.

	United States Operations	Canadian Operations	Other International Operations	Total
Year Ended August 29, 2004				
Total revenue	\$39,427,622	\$6,042,804	\$2,636,566	\$48,106,992
Operating income	1,121,122	214,518	50,008	1,385,648
Depreciation and amortization	364,432	40,220	36,069	440,721
Capital expenditures	560,387	89,748	55,485	705,620
Long lived assets	5,853,103	675,871	734,723	7,263,697
Total assets	12,107,613	1,717,962	1,266,973	15,092,548
Net assets	5,888,495	928,937	807,378	7,624,810
Year Ended August 31, 2003				
Total revenue	\$35,119,039	\$5,237,023	\$2,189,490	\$42,545,552
Operating income	927,590	199,043	29,995	1,156,628
Depreciation and amortization	323,850	33,732	33,720	391,302
Capital expenditures	698,713	68,432	43,520	810,665
Long lived assets	5,705,675	612,647	641,686	6,960,008
Total assets	10,522,260	1,579,972	1,089,456	13,191,688
Net assets	5,141,056	783,521	630,403	6,554,980
Year Ended September 1, 2002				
Total revenue	\$32,310,812	\$4,750,173	\$1,701,514	\$38,762,499
Operating income	924,330	192,161	15,044	1,131,535
Depreciation and amortization	281,812	33,477	26,492	341,781
Capital expenditures	868,069	35,098	135,438	1,038,605
Long lived assets	5,387,772	514,854	620,993	6,523,619
Total assets	9,418,500	1,198,992	1,002,771	11,620,263
Net assets	4,485,487	617,731	591,019	5,694,237

The accounting policies of the segments are the same as those described in Note 1. All inter-segment total revenue and expenses are immaterial and have been eliminated in computing total revenue and operating income.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
(dollars in thousands, except per share data) (Continued)

Note 10—Quarterly Financial Data (Unaudited)

The two tables that follow reflect the unaudited quarterly results of operations for fiscal 2004 and 2003.

	52 Weeks Ended August 29, 2004				
	First Quarter 12 Weeks	Second Quarter 12 Weeks	Third Quarter 12 Weeks	Fourth Quarter 16 Weeks	Total 52 Weeks
REVENUE					
Net sales	\$10,309,822	\$11,330,214	\$10,672,737	\$14,832,939	\$47,145,712
Membership fees	211,656	218,760	224,502	306,362	961,280
Total revenue	10,521,478	11,548,974	10,897,239	15,139,301	48,106,992
OPERATING EXPENSES					
Merchandise costs	9,220,122	10,101,977	9,540,312	13,229,605	42,092,016
Selling, general and administrative	1,032,413	1,084,605	1,050,728	1,430,131	4,597,877
Preopening expenses	10,125	4,216	4,552	11,558	30,451
Provision for impaired assets and closing costs, net	4,000	3,000	(8,500)	2,500	1,000
Operating income	254,818	355,176	310,147	465,507	1,385,648
OTHER INCOME (EXPENSE)					
Interest expense	(8,475)	(8,261)	(9,004)	(10,911)	(36,651)
Interest income and other	7,903	13,072	14,188	16,464	51,627
INCOME BEFORE INCOME TAXES	254,246	359,987	315,331	471,060	1,400,624
Provision for income taxes	94,071	133,195	116,673	174,292	518,231
NET INCOME	<u>\$ 160,175</u>	<u>\$ 226,792</u>	<u>\$ 198,658</u>	<u>\$ 296,768</u>	<u>\$ 882,393</u>
NET INCOME PER COMMON SHARE:					
Basic	<u>\$ 0.35</u>	<u>\$ 0.49</u>	<u>\$ 0.43</u>	<u>\$ 0.64</u>	<u>\$ 1.92</u>
Diluted	<u>\$ 0.34</u>	<u>\$ 0.48</u>	<u>\$ 0.42</u>	<u>\$ 0.62</u>	<u>\$ 1.85</u>
Shares used in calculation (000's)					
Basic	457,632	458,228	459,074	461,268	459,223
Diluted	480,348	481,537	482,485	485,073	482,459
Dividends per share	\$ —	\$ —	\$ 0.10	\$ 0.10	\$ 0.20

Note 10—Quarterly Financial Data (Unaudited) (Continued)

	52 Weeks Ended August 31, 2003				
	First Quarter 12 Weeks	Second Quarter 12 Weeks	Third Quarter 12 Weeks	Fourth Quarter 16 Weeks	Total 52 Weeks
REVENUE					
Net sales	\$9,010,571	\$ 9,920,324	\$9,344,959	\$13,416,845	\$41,692,699
Membership fees	188,014	193,843	198,112	272,884	852,853
Total revenue	9,198,585	10,114,167	9,543,071	13,689,729	42,545,552
OPERATING EXPENSES					
Merchandise costs	8,048,897	8,840,411	8,358,323	11,987,752	37,235,383
Selling, general and administrative	888,779	967,051	923,309	1,318,259	4,097,398
Preopening expenses	18,117	7,145	5,853	5,528	36,643
Provision for impaired assets and closing costs, net	5,000	4,500	6,000	4,000	19,500
Operating income	237,792	295,060	249,586	374,190	1,156,628
OTHER INCOME (EXPENSE)					
Interest expense	(8,468)	(8,003)	(8,715)	(11,734)	(36,920)
Interest income and other	7,634	8,983	9,179	12,729	38,525
INCOME BEFORE INCOME TAXES	236,958	296,040	250,050	375,185	1,158,233
Provision for income taxes	91,229	113,975	96,270	135,759	437,233
NET INCOME	<u>\$ 145,729</u>	<u>\$ 182,065</u>	<u>\$ 153,780</u>	<u>\$ 239,426</u>	<u>\$ 721,000</u>
NET INCOME PER COMMON SHARE:					
Basic	<u>\$.32</u>	<u>\$.40</u>	<u>\$.34</u>	<u>\$.52</u>	<u>\$ 1.58</u>
Diluted	<u>\$.31</u>	<u>\$.39</u>	<u>\$.33</u>	<u>\$.51</u>	<u>\$ 1.53</u>
Shares used in calculation (000's)					
Basic	455,570	455,927	456,370	457,187	456,335
Diluted	478,857	478,564	479,183	480,384	479,326
Dividends per share	\$ —	\$ —	\$ —	\$ —	\$ —

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GMM—Corporate Non-Foods
Stanley D. Winberg
GMM—Foods—San Diego Region
Charlie A. Winters
Director of Meat Operations

ADDITIONAL INFORMATION

A copy of Costco's annual report to the Securities and Exchange Commission on Form 10-K and quarterly reports on Form 10-Q will be provided to any shareholder upon written request directed to Investor Relations, Costco Wholesale Corporation, 999 Lake Drive, Issaquah, Washington 98027. Internet users can access recent sales and earnings releases, the annual report and SEC filings, as well as our Costco Online web site, at <http://www.costco.com>. E-mail users may direct their investor relations questions to investor@costco.com. All of the Company's filings with the SEC may be obtained at the SEC's Public Reference Room at 450 Fifth Street, NW, Washington, DC 20549. Additionally, the SEC maintains a website that contains reports, proxy and information statements and other information regarding issuers that file electronically with the SEC at www.sec.gov.

Corporate Office

999 Lake Drive
Issaquah, WA 98027
(425) 313-8100

Division Offices

Northern Division

Northwest Region

1045 Lake Drive
Issaquah, WA 98027

Bay Area Region

2820 Independence Drive
Livermore, CA 94550

Midwest Region

1901 West 22nd Street, 2nd Floor
Oak Brook, IL 60523

Eastern Division

Northeast Region

45940 Horseshoe Drive, Suite 150
Sterling, VA 20166

Southeast Region

3980 Venture Drive NW, #W100
Duluth, GA 30096

Southwest Division

Los Angeles Region

11000 Garden Grove, #201
Garden Grove, CA 92843

San Diego Region

4649 Morena Blvd.
San Diego, CA 92117

Texas Region

1701 Dallas Parkway, Suite 201
Plano, TX 75093

Canadian Division

Eastern Region

415 Hunt Club Road West
Ottawa, ON K2E 1C5

Western Region

3550 Brighton St.
Burnaby, BC V5A 4W3

International Division

United Kingdom Region

213 Hartspring Lane
Watford, Hertfordshire
England, UK WD2 8JS

Japan Region

4F Komahara Bldg 1-4-3
Yakumo, Meguro-ku
Tokyo, 152-0023 Japan

Korea Region

65-3-ka Yangpyung-dong
Youngdeungpo-ku
Seoul, Korea

Taiwan Region

255 Min Shan Street
Neihu
Taipei, Taiwan 114

Mexico Region

Boulevard Magnocentro #4
Col. San Fernando
La Herradura 52760
Huixquilucan, Mexico

Annual Meeting

Thursday, January 27, 2005 at 10:00 AM
Meydenbauer Center
11100 NE 6th Street
Bellevue, Washington 98004

Independent Public Accountants

KPMG LLP
801 Second Avenue, Suite 900
Seattle, WA 98104

Transfer Agent

Mellon Investor Services, L.L.C.
Costco Shareholder Relations
P. O. Box 3315
South Hackensack, New Jersey 07606
Telephone: (800) 249-8982
TDD for Hearing Impaired: (800) 231-5469
Outside U.S.: (201) 329-8660

Stock Exchange Listing

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